

# **A CASE ANALYSIS OF THE VIABILITY OF THE CURRENT REGULATION AND ENFORCEMENT MECHANISMS OF CORPORATE GOVERNANCE IN ZAMBIA**

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## LIST OF ACRONYMS AND ABBREVIATIONS

ABF	Associated British Foods
ADR	Alternative Dispute Resolution
BoZ	Bank of Zambia
CEO	Chief Executive Officer
CPI	Transparency International Corruption Perception Index
CRISA	Code for Responsible Investing In South Africa
FSDP	Financial Sector Development Plan
ESG	Environmental, Social and Corporate Governance
ESKOM	Electricity Supply Commission
FDI	Foreign Direct Investment
FINDECO	Finance & Development Corporation
IOD	Institute of Directors
IoDSA	Institute of Directors South Africa
IoDZ	Institute of Directors Zambia
IR	Integrated Reporting
IIRC	International Integrated Reporting Council
IT	Information Technology
JSE	Johannesburg Stock Exchange
LSE	London Stock Exchange
LuSE	Lusaka Stock Exchange
MINDECO	Mining & Industrial Development Corporation
OECD	Organisation for Economic Co-operation and Development
PRI	Principles of Responsible Investing
RDA	Road Development Agency
RI	Responsible Investing
SA	South Africa

SABC	South African Broadcasting Corporation
SI	Statutory Instrument
SMEs	Small & Medium Enterprises
UK	United Kingdom
USA	United States of America
UNPRI	United Nations (Principles of Responsible Investing)
VAT	Value Added Tax
ZESCO	Zambia Electricity Supply Corporation
ZIMCO	Zambia Mining & Industrial Development Corporation
ZWK	Zambian Kwacha

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## **Dedication**

**TO**

**Maureen K Mwanawasa & Levy Patrick Mwanawasa**

**Mum & Dad**

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**Mrs Maureen K. Mwanawasa**

**Mr Richard Foster**



## **ABSTRACT**

The narrative has changed. It is no longer ‘Africa is rising’ but ‘Africa has risen’. Africa’s economic potential is being sung from all corners of the world. One would think that the continent would undergo another ‘scramble for Africa’ following on from this economic boom. However, it is also clear that all this growth and foreign investment into African development cannot be embraced in the absence of proper commercial institutional structures and policy guidelines in the areas of corporate governance. While these structures may already exist to some degree, the areas of greatest concern are those of enforcement and regulation. This dissertation therefore examines the case for strengthening the regulation and enforcement mechanisms of corporate governance in Africa using Zambia as a case study. After an analysis of the law and the institutional framework surrounding corporate governance in Zambia, it becomes evident that the current self-regulatory system is weak and inadequate in terms of ensuring compliance: this shortcoming ultimately makes its *raison d’être* futile. A method of comparative law will be used to evaluate other models of enforcement and regulation by internationally recognised corporate governance codes and legislation in the United Kingdom, United States of America, South Africa and The Organisation for Economic Co-operation and Development (OECD). The objective is to try to answer the questions of what measures work well and to what extent; this information is used to ascertain which model would be suitable for Zambia to address the problems of regulation and enforcement. It should be noted however from the outset that this paper does not advocate for a ‘copy and paste’ *modus operandi* in responding to the challenges of corporate governance in Zambia. There is no one formula to answer economic corporate governance issues but these policies which have been successful elsewhere can be used as a basis to create an organic formulae that would ultimately be suitable for Zambia, taking into account the issues that are unique to its business culture, fiscal policies and economic growth among others.

## Section I: INTRODUCTION

In this dissertation, it is noted that self-regulation may be internationally acclaimed and may seem appealing with its hyperbolic connotations of ‘freedom.’ However, it is then argued that most African countries, and Zambia in particular, do not yet have a mature enough environment to entrust enforcement and regulation of the principles of corporate governance to the market. Zambia is a relatively small and young economy<sup>1</sup> and is still assessing how it can encourage and also regulate the entry of Foreign Direct Investment (FDIs) into the country; this can be done by having a good corporate governance framework in place that will maintain investor confidence while not deterring the investor with strict rules. This dissertation also argues that a mandatory regulatory framework enforced by law could yield a more effective result. Several examples have been cited in an attempt to give a better picture of corporate governance on the continent and in Zambia in particular: these include Illovo, Zambia Sugar (South African FDI), Zambeef PLC and the general participation of Chinese investors in Zambia. While accepting that these FDIs are migrating to Zambia for profit, the country’s aim is also to benefit through sustainable development and to gain income from these investments. It is therefore important for Zambia to build strong policy regulatory frameworks in an effort to protect its own interests and to ensure accountability, transparency, responsibility, fairness and discipline in corporate transactions. This dissertation concludes by giving recommendations to Zambia by blending in some of the key features of the hybrid models; for example the OECD, UK, USA and SA Corporate Governance Codes; at the same time there is a very strong emphasis on the importance of effective ethical leadership and stakeholder inclusivity in relation to successful enforcement and regulation.

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<sup>1</sup> Mwanamutanda, Ngoma, October 2013, ‘Zambia’s jobs challenge: The World Bank discusses realities on the ground, Issue 2.

The International Bank for Reconstruction and Development/THE WORLD BANK < [http://www-wds.worldbank.org/external/default/WDSPContentServer/WDSP/IB/2013/10/11/000442464\\_20131011131704/Rendered/PDF/818160WP0P13230Box0379846B00PUBLIC0.pdf](http://www-wds.worldbank.org/external/default/WDSPContentServer/WDSP/IB/2013/10/11/000442464_20131011131704/Rendered/PDF/818160WP0P13230Box0379846B00PUBLIC0.pdf) > accessed 1 March 2015.

## 1.1. BASIS FROM WHICH THE TOPIC HAS EVOLVED

Corporate governance is currently one of the world's most widely discussed issues. But what do we know about its composition and its origins? Is it a 'system of checks and balances, to ensure compliance with legal and regulatory obligations, a risk management process, accountability to stake holders?'<sup>2</sup> Or is it a 'process of controlling management, taking into account interests of stakeholders, aim[ing] at ensuring responsible behaviour, [with the] ultimate goal to achieve maximum efficiency?'<sup>3</sup> It is actually all of this. But, who are the stakeholders, employees, the community and the environment? What are the foundations of corporate governance? What is the importance of effective regulation and enforcement? These are the questions that section 1 aims to answer.

There is no single and generally accepted definition of what constitutes the notion of 'corporate governance.' One pioneer and champion of corporate governance, Sir Adrian Cadbury, explains corporate governance as 'the system by which companies are directed and controlled.'<sup>4</sup> Although later expanded, this definition did not initially refer to issues of company management. There are several definitions available for corporate governance as noted above; nonetheless, the definitions by Naidoo, Du Plessis et al., and Cadbury, quoted above, together give a solid starting point to unpacking this concept of corporate governance. To understand the origins of this concept further, historical landmarks of corporate governance cannot be ignored; therefore what follows is essentially the 'Foundations of corporate governance' from an historical point of view. A cumulative definition of corporate governance does not just require companies to behave responsibly and achieve a maximum level of efficiency and profitability, but also calls for companies to show characteristics of what is termed as 'GOOD' corporate governance. Lord Cadbury expanded on these characteristics of 'Good' corporate governance by including: discipline, transparency, independence (having different people on the board to give reports etc., independently), accountability, responsibility (e.g. who should have been responsible for the 2008 financial crisis) and fairness (e.g. what is 'right', what is

<sup>2</sup> Ramani Naidoo, 2009, *Corporate Governance*, 2nd edn., Lexis Nexis: Durban

<sup>3</sup> Du Plessis, Hargovan, Bagaric, 2011, *Principles of Contemporary Corporate Governance*, 2<sup>nd</sup> edn, 2

<sup>4</sup> ibid 2 p 1

‘decent’ and what is ‘fair’)<sup>5</sup>. These are the characteristics and or philosophies on which corporate governance practice and guidance codes are built. The codes provide a structure, awareness and guidance in which all stakeholders need to operate if their corporates and states are to be successful. In order to understand these definitions further one must go back into history and look at the foundations of corporate governance and why it is important today.

## 1.2. FOUNDATIONS OF CORPORATE GOVERNANCE

It is appropriate to start from the mid-1800s in London, which was then described as the financial powerhouse of the world<sup>6</sup>. The US at that time was described as a mining village whereas the United Kingdom was booming with economic globalisation and free trade<sup>7</sup>. This is important to note, especially when looking at the developments of the United Kingdom in the late 1800s such as the enactment of the basic financial act (Joint-Stock Companies Act of 1844); this Act improved the ability of people to invest in companies. The UK was clearly experiencing an industrial revolution and in order to keep this industrialisation going, *labour* and *capital* were needed. From this point, a schism in company ownership in the UK became more apparent. ‘Family owned businesses’ and companies started to change composition with the introduction of other shareholders and formalities on how companies would essentially be run from that time onwards (Jensen, 1993). The Joint-Stock Companies Act of 1844 provided no limited liability for shareholders<sup>8</sup> but required directors to perform certain corporate governance functions such as: appointment of a chairman, holding meetings for board members, engaging auditors who were to report to the members and keeping accounting books. Limited liability was only introduced in the 1855 Limited Liability Act. Nonetheless, company direction changed course and was

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<sup>5</sup> Muhammad Rafiq, 2012, ‘Impact of corporate governance on perceived organizational success (Empirical Study on Consumer Banks in Lahore, Pakistan),’ *International Journal of Business and Social Science*, 3, 13

<sup>6</sup> Cassis, Youssef, 2006, ‘*Capitals of capital: A History of International Financial Centres, 1780-2005*, 1<sup>st</sup> edn. Cambridge: Cambridge University Press

<sup>7</sup> UK Parliament website, The Industrial Revolution <  
<http://www.parliament.uk/business/publications/parliamentary-archives/archives-highlights/industrial-revolution/>> accessed 2 March 2015

<sup>8</sup> Re Sea Fire and Life Assurance Co., Greenwood’s Case (1854) 3 De GM & G 459

expected to be effected by two primary bodies: ‘shareholders in general meeting’ and ‘board of directors.’ There were a few checks and balances to control directors such as: the common law duties of care, skill and fiduciary duty of good faith, articles of association and statutory rules such as capital maintenance rules. However, in the 20<sup>th</sup> century, companies grew even bigger and their dispersed shareholding resulted in greater managerial authority, leading to a call for stricter corporate governance structures.<sup>9</sup>

Furthermore, more stringent corporate governance structures and rules were enacted in the UK in the late 1980s and early 1990s as a result of scandals and corporate failures; for example the Robert Maxwell saga<sup>10</sup> and Polly Peck<sup>11</sup> scandals. These episodes led to the London Stock Exchange (LSE) and accounting profession to commission a report by a committee led by Lord Cadbury on the financial aspects of corporate governance. In his book, ‘Cases in Corporate Governance’ Wearing notes that some of the recommendations in the Cadbury Report, which actually formed the genesis of corporate governance in the UK, were a direct response to the Maxwell case.<sup>12</sup> For example, the first British Cadbury corporate governance report introduced by Sir Adrian Cadbury introduced the concept of auditing by focusing on three main components: firstly, the chairman of a company should be separate from the chief executive of a company; secondly, a company should have three non-executive directors with no financial or personal affiliation to the executives. Thirdly, but most importantly, the Cadbury report took into account Robert Maxwell’s unmanaged and uncontrolled expenditure and duly indicated that audit committees must also be composed of non-executive directors.<sup>13</sup> The recommendations of this and later reports have been implemented by the LSE as listing requirements. In South Africa, similar reports were instigated by the Institute of Directors; the King Report on corporate governance, led by Professor Mervyn King, was developed and

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<sup>9</sup> Jensen, M.C., 1993, ‘The modern industrial revolution, exit, and the failure of internal control systems,’ *The Journal of Finance*, 48 (3), 831–840

<sup>10</sup> Robert Wearing, 2005, ‘*Cases in Corporate Governance*’ 1<sup>st</sup> edn, SAGE Publications Ltd, 38

<sup>11</sup> The Polly Peck scandal involved false production of financial reports submitted by Asil Nadir who was CEO of a British textile company named Polly Peck International; it collapsed in 1990 due to Nadir’s syphoning of company power on the basis that he had powers over-riding of the board. This is an example of another issue that the Cadbury Report aimed to address.

<sup>12</sup> *ibid* 9

<sup>13</sup> The Committee on the Financial Aspects of Corporate Governance, 1992 *Financial Aspects of Corporate Governance*, 1<sup>st</sup> edn, Gee & Co Ltd

incorporated into the Johannesburg Stock Exchange (JSE) listing requirements. Thus placed South Africa in the forefront with one of the leading corporate governance codes in the world championing the importance of corporate governance.

During the last two decades, the concept of corporate governance has come to the fore internationally, with countries such as the United States of America, Germany, Brazil and China emphasising it, while African countries such as Zambia have not been left behind. The Zambian Lusaka Stock Exchange Corporate Governance Code (LuSE Code) was launched in 2005 in conjunction with the Institute of Board Zambia (IoDZ), which was established in April 2000. These developments occurred after Zambia noticed the importance of the concerns that corporate governance principles aimed to tackle. The dynamic environment in which these companies and businesses operate consists of different stakeholders such as employees, consumers, the environment, the community at large as well as shareholders. Corporate governance has therefore had an effect on the world at large to the extent that the governance of companies is as important as the governance of a country; this will later be seen in discussion of the 2008 World economic crisis. It is through this type of world crisis that one sees the importance of, and the need for, effective enforcement and regulation of corporate governance in Zambia.

### **1.3. THE IMPORTANCE OF EFFECTIVE REGULATION AND ENFORCEMENT**

The 2008 Global Financial Crisis saw the bailout of banking institutions by governments as an intervention to prevent a total collapse of financial institutions worldwide.<sup>14</sup> This affected other sectors of the world economy such as the housing sector, banking sector and consumer goods markets. It had far reaching implications in which most investors lost their equity investments and also gave rise to new, hostile financial regulations. The value of investments was lost through a combination of speculation and holding on to toxic assets. Even more worrying was the fact that public investors held most of these investments but the corporations and the hedge

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<sup>14</sup> Adrian Blundell-Wignall, Paul Atkinson and Se Hoon Lee, 2008, 'The current financial crisis: Causes and policy issues,' *Financial Market Trends*, OECD, 13-16

funders were also investing money irresponsibly even when they knew these investments were not sustainable and that they had a moral obligation to make responsible investments. Moreover, hedge fund institutional managers paid themselves exorbitant bonuses despite this obligation. In short, the management were over-rewarding themselves for their poor performance as well as ‘cutting corners.’ The wake of the collapse led to the financial crisis and as a result, regulation was further increased to address the problem of weak corporate governance.<sup>15</sup> Also, governments have stepped in with more stringent structures to limit certain types of bank bonuses and the type of investment portfolios that can be devised by financial institutions.

For example, in South Africa in 2015, the South African Minister of Finance, Nhlanhla Nene, was quoted in an article in the African Hedge Fund News website as emphasising that ‘the main objective of the hedge fund regulation is to protect investors and to assist with monitoring systemic risk, while promoting the integrity of the industry’.<sup>16</sup> This scenario serves as a reminder of the importance of effective enforcement and regulation of corporate governance insofar as good governance tends to channel corporate decisions in the right direction and consequently encourages more investment by protecting the investor from managerial misbehaviour. The ‘Good’ in ‘Good Governance’ can be understood as referring to workable systems of governance that will ensure accountability, transparency, responsibility, fairness and discipline<sup>17</sup> in both corporate and state institutions. Christophe Volonté, one of Switzerland’s renowned specialists in corporate governance underscores this point in his writing by stating that, “Good” corporate governance is believed to reduce the likelihood of bad or wrong management and, as a result, to create shareholder value.’<sup>18</sup> This is exceedingly important especially with the rise of the modern corporation<sup>19</sup> where there is need for clearer limits to be imposed on the exercise of power by companies; this was underlined by the financial crisis. Furthermore,

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<sup>15</sup> Blundell-Wignall et al., ‘The current financial crisis’, 11

<sup>16</sup> An article commenting on the strengthening of the financial investment guidelines in South Africa: ‘Clarity on hedge fund regulation a boost for the industry,’ < <http://www.hedgenewsafrika.com/page/reading-room/1649943-Clarity-on-hedge-fund-regulation-a-boost-for-the-industry> > accessed 2 March 2015

<sup>17</sup> ibid 5

<sup>18</sup> Volonté C., 2012, ‘*Foundations of Corporate Governance*,’ 6

<sup>19</sup> O’Kelley C., 2013, ‘*The Evolution of the Modern Corporation: Corporate Governance in Context*’



corporate governance is important as it makes good business sense to reap the benefits that arise from a workable corporate governance system.

### 1.3.1. Access to capital

According to the McKinsey Investor Opinion poll, investors are generally more prepared to pay a premium for good governance, showing that corporate governance is important for improving an institution's chances of accessing capital<sup>20</sup>.

### 1.3.2 Foreign Direct Investments (FDIs)

The legal and regulatory approach to corporate governance in a country can lead to higher FDI; however, this is debatable if one considers China in Africa. The presence of Chinese foreign direct investment can be looked at from two different angles: a positive angle and a negative one.

Firstly, the positive angle is that China is attracted to the growth in business opportunities in Africa and the low tax policies that accompany it. Although this is a positive opportunity for African countries such as Zambia to earn foreign exchange through trade with China and to improve their economies, it can also be negative if African countries are offered a poor deal. For example, China has increased its investment portfolio on the continent which is evident by their increased presence on every aeroplane flight into and out of Africa. Thus, 'China is now the largest single trading partner for sub-Saharan Africa'<sup>21</sup> which is partly the result of offering cheap infrastructure construction deals to African governments in exchange for long-term, high-value assets in Africa such as land and mines and mineral royalties. The Chinese conduct road construction projects in exchange for gold, copper, diamonds, manganese and other unprocessed mineral ores, with very little value addition. This situation is very common on the continent, where the Chinese get a better bargain when one compares the value addition of the minerals extracted, against the value of roads that almost last a life time.<sup>22</sup> This situation represents the negative angle.

<sup>20</sup> McKinsey Investor Opinion Survey, 2000, McKinsey & Company, 6

<sup>21</sup> Paulo Drummond and Estelle Xue Lui, 'Africa's rising exposure to China: How large are spillovers through trade?' International Monetary Fund Working Paper WP/13/250 p 4, 2013

<<http://www.imf.org/external/pubs/ft/wp/2013/wp13250.pdf>> accessed 2 March 2015

<sup>22</sup> Aljazeera, the news broadcaster ran a programme analysing whether Chinese presence in Africa is investment or exploitation. Refer: 'Inside Story, China in Africa: investment or exploitation?' Aljazeera, 4 May 2014 <http://www.aljazeera.com/programmes/insidestory/2014/05/china-africa-investment-exploitation-201454154158396626.html>> accessed 2 March 2015



One should not imagine that African governments are unable to negotiate a better deal for themselves and capitalise on the benefits from these developmental projects. However they are hampered by the lack of decent corporate governance systems, a lack of expertise in terms of the composition of the teams responsible for facilitating the transactions<sup>23</sup> as well as a lack of checks and balances in the system. All these shortcomings allow for poor risk management, poor investment decisions and lack of responsible leadership; indeed, the leadership is easily influenced by bribery, fraud and exploitation to the benefit of those in power and in influential positions but at the expense of the masses. This leads to the third point: corruption can have serious cost implications on corporate governance.

### 1.3.3 Corruption

Corruption has serious cost implications and therefore the presence of effective regulations and enforcement mechanisms of corporate governance helps to curb the levels of corruption in business, especially on the African continent. Africa records a score of less than 50% regarding corruption. Zambia has a score of 38% and is ranked 85<sup>th</sup> out of 175 countries in the Transparency International Corruption Perception Index (CPI) and this borders on the zone of the most highly corrupt countries in the world<sup>24</sup>. Zambia would score higher by reducing corruption, promoting ethical leadership, having a strong and vocal civil society and by putting pressure on the allocators of capital in companies to demand that principles of corporate governance are upheld. These issues arise in responsible investing and in turn ensure accountability and responsibility to the employees, communities, consumers and environmental management concerns [stakeholders]. One of the main arguments this paper aims to advance is that of strengthening the legal and regulatory frameworks in order to ensure practice of good governance both in the public and private sector. However, it should be strongly noted that the introduction of more corporate governance legislation would not necessarily result in better corporate governance, given the rampant corruption on the continent. Therefore, the fight against corruption should be fundamental to the success of effective regulation and enforcement of corporate governance.

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<sup>23</sup> *Chinese Investments in Special Economic Zones in Africa: Progress, Challenges and Lessons Learned*, World Bank, 6, 77

<sup>24</sup> Transparency International Corruption Perception Index (CPI), 2014. Results measuring public sector corruption in 175 countries.

### 1.3.4 Investor Responsibility

There is a growing global expectation that investors should take on a holistic approach as they invest: this entails taking into consideration the environmental, social and corporate governance impact that they may have in the communities where they operate; both a short- and long-term approach are needed. In South Africa, the Code for Responsible Investing in South Africa (CRISA)<sup>25</sup> in conjunction with the United Nations Principles of Responsible Investing (UNPRI) not only govern this sphere of responsible investing but also work as instruments to guide the behaviour of the investor and what is expected of them as far as corporate governance is concerned.

Investment institutions such as hedge funds are responsible for ensuring that good governance is upheld in the companies and businesses in which they invest. There is also a need to have ‘pro-active shareholders’ who challenge the board and hold them accountable for ensuring that company policies actually achieve what they were intended for. This is important as it encourages companies to adhere to good corporate governance practices and responsible investing, resulting in a wider net-effect on beneficiaries, from good governance.

Shareholders and institutional investors need to enforce their rights and exert pressure using these rights, from two perspectives. Firstly, they should be pro-active shareholders and ask the right questions. Secondly, they can be influential by virtue of their positions on boards and through the legal framework by ensuring that environmental, social and corporate governance (ESG) issues are tabled and taken into consideration as part of their business strategies. The UNPRIs, which were established in 2006, encourage collaboration amongst investors<sup>26</sup> enabling them to have a consensus approach on incorporating corporate governance principles and

<sup>25</sup> CRISA was the only code of its kind in the world when it started but the United Kingdom has since formulated the ‘Stewardship Code’, which was released in 2010 by the Financial Reporting Council.

<sup>26</sup> Collaborative engagement: Takeover Regulation Panel, PRI South Africa Network Engagement Working Group with Executive Director of the Securities Regulation Panel (SRP), United Nations Global Compact, 2010

practices and effectively implementing these principles [UNPRI Principle 5<sup>27</sup>] in the transactions.

It is for this reason that South Africa produced the ‘Code for Responsible Investing in South Africa’ (CRISA) as a mechanism to guide the behaviour of investors and capital allocators; this was in addition to the main corporate governance codes. Some have argued however, that it is not ideal to have two separate codes: CRISA and the Corporate Governance King Report; in this situation, the more important of the two would be CRISA. Others have argued that both codes are unique in the sense that they do not have the same exact purpose; thus, CRISA is very specific on issues of responsible investing. This is a point at which the corporate governance commenter and business financial journalist, Ann Crotty, underscores the importance of keeping CRISA and the corporate governance report separate, because of their distinct purposes<sup>28</sup>.

### 1.3.5 Accountability

Public campaign movements in the recent past have demanded more ‘accountability’ from corporations, to ensure a more informed public and more accountable corporations. One of the fundamental requisites of good corporate governance is accountability to stakeholders. An example of this is of Nestlé, whose baby milk products have, over the years, been marred with ‘Baby Killer’ allegations in global campaigns. Even South African consumers have taken part by threatening a boycott of its products in an accusation that they are ‘causing infant illnesses and death in poor communities by promoting bottle feeding and discouraging breast feeding.’<sup>29</sup> The consumer in this case demands accountability from the producing company which is responsible not only to the consumer but also to the community, the employees, the environment and the shareholders, who entrust Nestle to invest their

<sup>27</sup> UNPRI, ‘Principle 5: We will work together to enhance our effectiveness in implementing the Principles. Possible actions:

- Support/participate in networks and information platforms to share tools, pool resources, and make use of investor reporting as a source of learning;
- Collectively address relevant emerging issues;
- Develop or support appropriate collaborative initiatives.’

<sup>28</sup> Ann Crotty, Kaylan Massie and Debbie Collier, 2006, ‘Executive pay in South Africa: Who should have a say,’ Juta and Company Ltd.

<sup>29</sup> Mike Miller, ‘Nestle baby milk scandal has grown up but not gone away,’ *The Guardian Newspaper* 2013 < <http://www.theguardian.com/sustainable-business/nestle-baby-milk-scandal-food-industry-standards> > accessed 6 January 2015

money. Therefore in the event of any problems or misfortunes or even praises, the company should be the first point of call as far as accountability is concerned.

### 1.3.6 Competitive advantage

Corporate governance is important because it encourages and ensures that players in the economic market adhere to good business practices, and to environmental, social and governance issues. It also maximises a company's competitive advantage as investors tend to look at investing in companies that are aware of corporate governance issues and which abide by these good business practices. Therefore, a company exhibiting good corporate governance has a competitive advantage over a less adherent competitor in the same field as adherence to good practices improves the company's image and consequently its performance.

## 1.4. OVERVIEW OF DISSERTATION

To begin with, corporate governance can be understood to deal with shareholders' expectations of a particular company or business. Moreover, it can and should be approached from a much broader sense of an 'inclusive stakeholder' approach of satisfying expectations of the various groups involved; this approach is supported and promoted by the OECD Principles of Corporate Governance. While definitions may vary, stakeholders in corporate governance include employees, shareholders, management, creditors, suppliers, the environment, the local community and even future generations.<sup>30</sup> One could argue that these stakeholders share a common risk, (i.e. the possibility of gaining benefits or suffering harm) as a result of the activities of the company in question. The difference between the two approaches is attributable to the tradition and culture in a particular jurisdiction. For example, in the United States and the United Kingdom the emphasis is on the relationship between shareholders and management, whereas in France or Germany a company is viewed as a partnership between capital and labour, providing for worker representation at board level.<sup>31</sup> In Zambia however, the corporate governance emphasis is mostly on shareholder

<sup>30</sup> Oliver Fremond, 2000, 'The Role of Stakeholders,' The Organization for Economic Co-operation and Development (OECD), 6, at <http://www.oecd.org/daf/ca/corporategovernanceprinciples/1930657.pdf> > accessed 1 March 2015

<sup>31</sup> Jean Du Plessis, James McConvil and Mirko Bagaric, 'Corporate Governance in selected Jurisdictions and the OECD Principles of Corporate Governance,' 1<sup>st</sup> ed: Cambridge University Press, 2005, 293

protection. A brief comparison of these jurisdictions is given, then discussed, in section IV of this paper. Nonetheless, it is important to understand and define in some detail who the various ‘stakeholders’ are.

As denoted above, stakeholders in corporate governance are considered to include shareholders, employees, creditors, consumers and the community at large. These stakeholders and their roles in corporate governance are described, below, in no order of preference or hierarchy.

Firstly, *shareholders* are providers of capital and their status is enshrined in the company legislation. Secondly, *employees* (workers) have interests in job safety and income; they can also participate in management in the workplace or on the board of directors, where they could act as shareholders if they benefit from share incentive schemes. The workers’ interest in training and skills development is one element of their interests promoted by corporate governance. This interest is also protected by legislation such as section 203 (4) of the South African Labour Relations Act that states: ‘A Code of Good Practice issued in terms of this section may provide that the code must be taken into account in applying or interpreting any employment law.’<sup>32</sup> Thirdly, *creditors* or providers of credit such as banks need to be sure that loans would be repaid and likewise, suppliers also want assurance they would be paid; these expectations are protected by legislation in most cases, under the Insolvency Acts and Credit Acts. Furthermore, *consumers* and the *community* might be dependent on particular products or services and therefore the issues of sustainability and the impact on the environment may arise through boycotts or through legislation enshrined in acts such as the Consumer Protection and Environmental Acts.

It is clear that there is a web of legislation addressing corporate governance issues. However, the enactment of large amounts of legislation is not, in itself, the solution for ensuring sound corporate governance practices and principles. There is also a need for effective regulation and enforcement mechanisms in order to ensure maximum compliance by all participants, leading to a better society. This is the issue that this dissertation will discuss. Compliance can be realised by having an inclusive

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<sup>32</sup> Section 203(4), South African Labour Relations Act, No. 66

stakeholder approach, as defined above, and involving stakeholders in regulation and enforcement, as will be seen in the ensuing sections of his report.

## 1.5. CONCLUSION

There is no single formula for addressing corporate governance issues. The history and background of the concept of corporate governance stems originally from developed countries; nevertheless, developing countries such as Zambia are trying to incorporate this concept in their business practices. This situation is one of the main challenges for effective corporate governance and therefore a ‘copy-paste’ mechanism will not suffice for developing countries. This notion of corporate governance affects us all globally and in various ways: this applies to both the developed and the developing countries, as well as to the public and private business sectors. The commentator Benjamin Mulili elaborates on this point by stating that ‘there is [a] need for developing countries to develop their own corporate governance models that consider the cultural, political and technological conditions found in each country.’<sup>33</sup>

From this perspective it can be seen that internationally recognised portions of corporate governance codes and legislation should only be used as guidelines or benchmarks in order to formulate unique codes specific to the dynamics and uniqueness of a particular state; they should not necessarily be regarded as the ‘perfect model.’ For effective regulation and enforcement to be achieved, all stakeholders and dimensions of culture, customs, tradition, politics, economics and the rule of law have to be taken into consideration in the construction of a corporate governance policy. In essence, the question this dissertation seeks to answer is: how can African countries, using Zambia as a case study, fashion their corporate governance policies that inspire effective enforcement and regulation structures?

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<sup>33</sup> Benjamin Mwanzia Mulili, 2011, ‘Corporate governance practices in developing countries: The case for Kenya,’ Southern Cross University

## SECTION II: BACKGROUND AND HISTORY OF CORPORATE GOVERNANCE IN ZAMBIA

### 2.1. INTRODUCTION

This section discusses the main developments in corporate governance in Zambia between 1964 and 2015. For purposes of discussion, the section is demarcated into five main periods, which are synonymous with a particular political dispensation: there are the Kaunda, Chiluba, Mwanawasa, Banda and Sata eras.

### 2.2. BACKGROUND AND HISTORY OF CORPORATE GOVERNANCE

When we examine the metamorphoses of corporate governance in Zambia, since the inception of the IoDZ in 2000 and the introduction of the LUSE Code in 2005, it becomes clear that there has been very little transformation in corporate governance in the past decade. This is even though the country has experienced unprecedented economic growth and transformation that has seen the need for proper corporate governance to be of paramount importance. This chapter proceeds from a simple analysis of economic growth in Zambia in the last five decades and uses the Zambian political progression as a guide. The chapter then discusses the five political governments since independence (1964) to date (2015) and looks at how each era has contributed to the development of corporate governance in Zambia.

#### 2.2.1. The Kaunda Era (1964-1991)

Corporate governance in the first three decades of post-independence Zambia was characterised by two main events: the formation of state-owned enterprise boards, and the enactment of the leadership code<sup>34</sup>.

The post-independence leadership held the view that the economic benefits of independence were not cascading quickly enough to the majority of its citizenry. As such, the Government of the Republic of Zambia under the leadership of Kenneth

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<sup>34</sup> William Tordoff, 1974, *'Politics in Zambia,'* University of California Press, 32

Kaunda decided to nationalise the economy by assuming 51 per cent<sup>35</sup> ownership of all existing businesses, and equitably dividing the benefits of economic development<sup>36</sup>. In most instances, the government bought mining, manufacturing and banking companies, which they did not even have the expertise to run. Importantly, the Kaunda Administration introduced two state institutions, the Finance and Development Corporation (FINDECO), and the Mining and Industrial Development Corporation (MINDECO) to oversee the activities of the newly acquired enterprises. Contrary to the best practices of corporate governance, the Board of Directors of these two institutions and newly nationalised enterprises was chaired by the Republican President.<sup>37</sup> By doing so, the government was acting as referee and player at the same time<sup>38</sup>. Even in the financial services sector, it was exceedingly difficult to regulate and operate the numerous nationalised banks. This not only blurred the reporting channels in state-owned enterprises but also made it more difficult to eradicate the wonton abuse of state-owned enterprises several generations later.

In addition to setting up FINDECO and MINDECO, which were later reorganised into the Industrial Development Corporation (INDECO) and the Zambia Mining and Investments Corporation (ZIMCO), the Kaunda Administration put in place a Leadership Code which restricted a firm's profits to a government stipulated amount. The Code was established to prevent people from becoming overly wealthy and was also intended to discourage private enterprises from exploiting the citizenry excessively. More specifically, the Leadership Code prescribed that all company profits in excess of K500, 000 were forfeited to the central government. A Leadership committee was set up to provide 'for a Tribunal to deal with breaches and alleged breaches of the code.'<sup>39</sup> This capping of company profits diminished the incentive for the few remaining private companies to grow. At the individual level, it indirectly promoted an attitude of laziness, as private citizens no longer saw the need to venture

<sup>35</sup> South African History website, 'Kaunda announces nationalization of Copper mines', 10 August 1969 < <http://www.sahistory.org.za/dated-event/kaunda-announces-nationalisation-copper-mines> > accessed on 2 March 2015

<sup>36</sup> Dr. Benedict Oramah, 2015, '*Foundations of Structured Trade Finance*,' Ark Group

<sup>37</sup> Habasonda M. Caiaphas, 2009, 'Towards a robust, self-sustaining economic empowerment financing paradigm,' University of Zambia

<sup>38</sup> Burton. J. Stuart, 2016, '*Exclusion: Centralisation and Contraction (1970–1974) - A 50-Year History of Zambia's Relationship with Foreign Capital*,' Palgrave Macmillan, 60 -69

<sup>39</sup> Cherry J. Gertzel, Carolyn Louise Baylies and Morris Szeftel, 1984, '*The Dynamics of the One-party State in Zambia*,' Manchester University Press, 19



out and participate in the business sector.<sup>40</sup> The reasoning behind this Code was to have everything under state control, which in hindsight was a severe impediment to corporate governance.

Collectively these initiatives, such as the formation of state-owned enterprise boards, and the enactment of the Leadership Code, severely undermined the institution of good corporate governance practices in Zambia.

### 2.2.2 The Chiluba Era (1991-2001)

The Chiluba regime was characterised by a surge in the number of privately owned corporations, following the implementation of an ambitious and wholesale privatisation programme in Zambia. During this time there was a relatively low level of knowledge of good corporate governance practices.

Many of the state-owned entities in INDECO and ZIMCO underperformed because of bad corporate governance procedures. Following advice given by the Bretton Woods Institutions, in particular the World Bank, the Government of the Republic of Zambia transferred most of the nationalised companies back into private hands through the mechanism of privatisation. As a precursor to the privatisation programme, Dr. Fredrick Chiluba, Zambia's second Republican President, dismantled the Leadership Code left by his predecessor in an attempt to attract increased private sector investment. Consequently, the 1990s saw a surge in both the volume of private investment and number of privately owned companies in Zambia. In the absence of proper corporate governance guidelines, several businesses in the mining, manufacturing and banking sectors struggled to put good corporate governance practices in place. In the banking sector for instance, there were several bank collapses.<sup>41</sup> According to Maimbo (2002:277), the bank failures of 1996 and 1997/8

<sup>40</sup> Mebelo Mutukwa, 1995, former managing partner at Pangae Partners

<sup>41</sup> In May 1995, Meridian Bank Zambia Limited collapsed. The African Commercial Bank and Commerce Bank followed this later that year. The turbulence experienced in the banking and financial sector had a severe impact on the banking and financial services system, resulting the failure of four more banks in 1997 and one in 1997. In December 1999, the African Commercial Bank, Credit Africa Bank, Manifold Investment Bank, Meridian BIAO Bank, and Prudence Bank were all in liquidation, while First Merchant Bank was undergoing re-organisation. The cost of these bank failures to the BoZ has been high, both financially and in terms of its reputation and credibility as a regulator and supervisor of the financial sector. As on 31 December 1997, the overdrawn accounts of the banking in liquidation at the Bank of Zambia were in excess of US\$ 30million. Source: Maimbo, Samuel Munzele, 2002, 'The diagnosis and prediction of bank failures in Zambia, 1990-98,' *Development Policy Review*, 20, 3, 261-278.

did not occur suddenly, but, rather, were the culmination of a long process of financial deterioration and breaches of the laws on corporate governance.

Critically underpinning these failures was the fact that the new private owners lacked knowledge of how to handle these enterprises. Most of the new directors of the newly privatised companies managed the corporate governance elements on a trial and error basis. The directors who succeeded in this trial and error process thrived but in contrast, the companies of unsuccessful directors simply collapsed. It was only toward the end of the Chiluba Era, that the Institute for Directors Zambia (IoDZ) was established to address this corporate governance deficit. The subject of corporate governance in Zambia cannot be spoken about without reference or attribution to the Institute of Directors Zambia (IoDZ) which saw and identified a knowledge gap and then created an institute responsible for the promotion of 'high standards of corporate governance in both the private and public sectors in Zambia, through education, training, and participation at relevant fora;<sup>42</sup> by doing so, it instilled a culture of the highest standard of ethical and professional behaviour amongst directors and boards in the country. The institute was commissioned on 7 April 2000 from a background of political and economic development, which should be discussed in order to understand the prolonged progression of corporate governance in Zambia. While the IoDZ has been useful in facilitating learning and knowledge sharing among the directors of newly privatised enterprises, the organisation still appears to be in its infancy. Some more time will be needed before the IoDZ can develop corporate governance guidelines similar to the King III report in South Africa.

To summarise: the Chiluba regime was marked by a surge in the number of privately owned corporations and by the establishment of the IoDZ following a comprehensive privatisation programme; this was the tipping point in the history of corporate governance practices in Zambia

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<sup>42</sup> Part of the Mission Statement of the Institute of Directors Zambia, accessed 14 February 2016

### 2.2.3. The Mwanawasa Era (2002-2008)

The corporate governance regime in the Mwanawasa Era was characterised by remarkable levels of economic growth and investment, and entrenchment of meritocratic systems.

The Mwanawasa Era saw exceptional growth and investment in the Zambian economy. Following four decades of economic contraction and stagnation under the Kaunda and Chiluba administrations, the Zambian economy grew sustainably at an average rate of 6.5% per year for seven years<sup>43</sup>. This growth had its roots in improved commodity prices and increased investor confidence in the economic policy environment. While acting together, these factors paved the way for significant increases in portfolio inflows and Foreign Direct Investment (FDI). It was during the Mwanawasa administration that foreign investors, for the first time, took investment positions in Zambian Kwacha denominated treasury bills, bonds and stocks on the Lusaka Stock Exchange (LuSE). Similarly, the country attracted mining investments in excess of US\$ 1 billion to set up new copper mines at Lumwana and Kansanshi in North Western Zambia.<sup>44</sup> With these vast investments came sophisticated corporate governance reforms and regulations in the banking and financial services sector: these were in the form of the Financial Sector Development Plan (FSDP).

In the public sector, the Mwanawasa administration prudently guided the country to the Highly Indebted Poor Countries (HIPC) completion point; this resulted in a complete write-off of Zambia's external debt in 2006.<sup>45</sup> This was a significant achievement if one bears in mind that the country had failed to reach this completion point during the Chiluba administration on account of imprudent fiscal management. The reason underpinning the Mwanawasa administration's success was that the administration always sought the assistance of the most competent individuals to help develop the country. He hired a team of competent economic managers and provided them with the space to do what they thought was professionally necessary. This

<sup>43</sup> Data from database: World Development Indicators last updates on 30 January 2015. Accessed: 13 February 2015

<sup>44</sup> Lumwana mine was set up in Zambia between 2002 and 2009

<sup>45</sup> International Monetary Fund (IMF) Press Release, 'IMF and World Bank support US\$3.90 billion in debt service relief for Zambia,' 8 April 2005, Press Release No. 05/80  
<https://www.imf.org/external/np/sec/pr/2005/pr0580.htm>

professionalism eventually cascaded down to all levels of the public and private sectors.

One possible yet fundamental criticism of the Mwanawasa regime was that corporate governance reforms did not completely match the levels of economic growth, investment and sophistication. To date, the corporate governance requirements for unlisted and privately owned medium-scale enterprises remain quite unclear. Despite all the strides that Zambia had made economically, its corporate governance structures have not developed at the same rate as the economy; indeed, the country's corporate governance guidelines have marginally lagged its rising levels of economic sophistication.

In sum, the Mwanawasa administration was an era of significant growth and consolidation of corporate governance structures and practices in Zambia.

#### **2.2.4. The Banda Era (2008 - 2011)**

The corporate governance regime under Rupiah Banda was mostly an extension of the Mwanawasa administration. One marked exception was the increase in financial regulation in the banking and financial services sectors that characterised the period after the financial crisis of 2008.

President Banda inherited many of the structures and technocrats from the Mwanawasa administration, which allowed him to maintain the status quo to a great extent. Banda leveraged the governance structures left by Mwanawasa which comprised a meritocratic system with clear-cut guidelines on how to invest in Zambia, how to qualify for tax exemptions, and how to access finance; these structures were used to inspire continued confidence in the country's economic policy management.

In the wake of the global financial crisis of 2008, the Banda Administration increased the level of surveillance of the banking sector and raised the required reserves ratio, which limited the proportion of deposits that banks could lend out; punitive measures were promised for those institutions not complying. It was through these increased surveillance activities that the Bank of Zambia discovered that

Finance Bank had been flouting the shareholding requirements; thus, a single shareholder held more than a 25 per cent stake in the bank, contrary to the law.<sup>46</sup> The Bank of Zambia prudentially took Finance Bank into curatorship in 2009. Following the takeover of Finance Bank, the Bank of Zambia outsourced the oversight of the day-to-day running of the bank to First National Bank (FNB) of South Africa.

In common with the Mwanawasa regime, the main shortcoming of the Banda era is that it failed to improve corporate governance requirements for unlisted enterprises.

Ultimately, the corporate governance regime under the Banda administration was characterised by a tightening of regulations in the banking and financial services sector in response to the international financial crisis of 2008.

#### **2.2.5. The Sata Era (after 2011-2014)**

In contrast to the preceding Mwanawasa regime, the Sata era was characterised by a significant decline in the corporate governance environment. Instead of building on the successes of previous administrations, President Sata blatantly disregarded corporate governance requirements.

One could argue that serious challenges arose during the Sata era because the head of state did not appreciate the value of the corporate governance requirements in Zambia. However, it is important to note that the Zambian governmental system allows the president to appoint all chief executive officers (CEOs) in all parastatal institutions and gives authority to the minister to appoint the board of directors. This contradicts good corporate governance practices because accountability is very difficult to enforce when the president appoints the CEO and then entrusts his subordinate minister to appoint the board. This basically rendered the purpose of the board futile in the Sata era because the performance evaluation of the CEO could only

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<sup>46</sup> In 2010, the Bank of Zambia had seized the lender for breaching financial laws; it had found that Dr. Rajan Mahtani, the lender's largest shareholder, directly and indirectly held more than 25 per cent of the shares in the bank in contravention of CAP 387 (Banking and Financial Services Act) of the Laws of Zambia. He had agreed to sell it to Johannesburg-based FirstRand. Source: Matthew Hill, 2015, 'Diamond's Atlas Mara said in talks to buy Finance Bank Zambia' <http://www.bloomberg.com/news/articles/2015-06-23/diamond-s-atlas-mara-said-in-talks-to-buy-finance-bank-zambia>

be done by the president himself and not the board: neither the board nor the minister had the power to remove the CEO as the head of state had appointed that person.

Therefore, this era was characterised by a lack of proper separation of powers that would provide for effective checks and balances in the performance of the parastatals. The CEO, by virtue of being directly appointed by the president, was so powerful that he or she had no obligation to be accountable or answerable to the board or the minister in charge of that particular ministry. A recent example of this in Zambia was the selection of the two CEOs for the Zambia Railways and Zambia Electricity Supply Corporation (ZESCO); these were two of President Sata's first appointments after his inauguration as President of the Republic of Zambia in 2011<sup>47</sup>. The problem arising from both appointments was the same: how was the board supposed to manage the CEO when the president appointed that CEO and the minister appointed the board? These CEOs had more power than the board and therefore could not even be fired or disciplined by the board.

Another example taken from the same period was the way the Sata government handled the Roads Board, known in Zambia as the Road Development Agency (RDA); this had moved its operating premises to the president's residence and had not been audited between 2011 and 2014.<sup>48</sup> As a semi-autonomous body, issuing contracts to the private sector, the RDA should have been operating as a stand-alone body but it was being controlled, in the Sata era, from State House. Proper corporate governance was very difficult to apply to an entity housed within the presidency, with much secrecy prevailing; it became a breeding ground for corruption and impropriety and misapplication of public funds; all of this is inconsistent with the practice of corporate governance.

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<sup>47</sup> President Sata directly appointed Mr. Cyprian Chitundu as Managing Director of the ZESCO (<http://www.zambia-weekly.com/archive/Zambia%20Weekly%20-%20week%2041.pdf>) and Professor Clive Chirwa as Chief Executive Officer of Zambia Railways Limited (<https://www.lusakatimes.com/2012/11/15/professor-clive-chirwa-zambia-railways-boss/>) in 2011 and 2012 respectively.

<sup>48</sup> President Sata moved the Roads Development Agency (RDA) from the Ministry of Works and Supply to the State House in 2012 (<http://zambiadailynation.com/2013/04/27/rda-in-road-contract-scandal/>)

Furthermore, a point of view from the private sector is that if Zambia had progressive corporate governance structures during the Sata administration, then it would not have accumulated a debt of US \$4.8 billion dollars in the first three years of the Sata presidency.<sup>49</sup> Others have argued that President Sata was initially reluctant to raise taxes because he could easily access debt from international markets and the Bretton Woods institutions;<sup>50</sup> however, when the borrowing limits had been reached, the government was under considerable pressure to tax the mines more to meet the high demands of its infrastructure programme. Government decided to raise the taxes for the largest beneficiaries of infrastructure services rather than engaging the mines in discussions; the mines could have contributed as part of their corporate social responsibilities to the community and to the country as a whole. However, the government simply introduced various statutory instruments (e.g. SI 33 and SI 35<sup>51</sup>) and also a new requirement on Value Added Tax (VAT); thus, companies needed to produce receipts to get their VAT refunds and this left the companies in worse positions than before, because the government was not able to pay back the money owed in VAT refunds. Government therefore increased their taxes to counter this but the whole process had not been planned properly: in response, the mines retaliated by threatening to close operations.<sup>52</sup>

Financial analyst, Maambo Hamoundu, is quoted in Zambia's Daily Nation Newspaper as questioning Government's failure to pay VAT refunds to mines, which in response to non-payment were threatening to close and lay off workers in order to sustain their operations; after all, the mines relied on payment then reinvestment of

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<sup>49</sup> Government of the Republic of Zambia, 2015, National Budget Speech, Lusaka: Ministry of Finance

<sup>50</sup> This term refers to the three institutions created at the Bretton Woods conference of 1945. These are: the World Bank, the International Monetary Fund (IMF) and the General Agreement on Tariffs and Trade (GATT and its successor, the World Trade Organization).

<sup>51</sup> Statutory Instrument 33 and Statutory Instrument 35 were intended to restrict trading in foreign currencies and enhance accountability in the reporting of copper exports.

<sup>52</sup> Sinyangwe Chiwoyu, quotes a source from the Zambian Ministry of Finance in his article: '[Zambian Finance Minister] Chikwanda wants government to pay mines \$600m in VAT refunds,' 28<sup>th</sup> July 2014, Post Newspaper Zambia: 'The minister [Chikwanda] says our current fiscal space is severely constrained for us to refund these mining companies of their VAT but that we can only clear the huge backlog by negotiating staggered repayments with the mining companies after we have instituted a more prompt VAT refunds regime.' See more at: <http://www.postzambia.com/news.php?id=400#sthash.Ko0T4HEO.dpuf>

some of the VAT refunds into their operations<sup>53</sup>. If government had maintained sufficient dialogue with the mines then it would have requested the mines to meet some of the costs of the new infrastructure as a corporate social responsibility initiative; this could have been done without having to increase the tax and putting the jobs of thousands of Zambians at risk.

In sum, one could argue that the Sata administration was an era of diminished corporate governance structures and practices in Zambia.

### 2.2.6. Conclusion

In conclusion: it is clear the five governmental eras are characterised by differences in their contribution towards, and impact on, the progression of corporate governance in Zambia. The Kenneth Kaunda administration had an extremely limited private participation, which resulted from the constraints of the Leadership Code. Even if there had been a private sector during his time, it would not have grown. The Fredrick Chiluba administration was a period of trial and error. The Levy Mwanawasa era actually saw consolidation of all the trials of the previous administration, and the Banda era further consolidated these in an effort to avoid the collapse of Zambian banks during the 2008 World Economic Crunch; however, no new developments occurred during this time. Finally, the Michael Sata administration caused a regression because government started having direct influence on appointments of boards again and it became involved in the actual operations: all of these developments caused the progression of corporate governance in Zambia to take a few steps backwards. Poor corporate governance discourages foreign direct investment into a country as business operations are politically regulated, thereby providing very little investor security in the absence of a proper corporate governance policy.

## 2.3. A PROLONGED INFANCY

<sup>53</sup> Daily Nation Reporter, 'VAT refund can help ease mines pressure – expert' Zambia Daily Nation Newspaper, 21 September 2015. <http://zambiadailynation.com/2015/09/21/vat-refund-can-help-ease-mines-pressure-expert/>



Any discussion of corporate governance in Zambia needs to make reference to the Institute of Directors Zambia (IoDZ). This Institute is responsible for identifying the need to promote, ‘high standards of corporate governance in both the private and public sectors in Zambia, through education, training, and participation at relevant fora;<sup>54</sup> the aim was to instil a culture of ensuring the highest standard of ethical and professional behaviour amongst directors and boards in the country. The institute was therefore commissioned on 7 April 2000 against a background of political and economic developments, which has been discussed above. This development brought understanding to the prolonged progression of corporate governance in Zambia despite its general weak and inadequate nature of failing to ensure maximum compliance in the sector. Despite certain shortcomings, the IoDZ continues to promote the advancement of best business practices and has promoted some successful interventions in the recent past.

### 2.3.1. Awareness

On the subject of awareness, the Institute of Directors Zambia has been conducting corporate governance training and sensitisation programmes since 2001, aimed at both the private and public sector companies, organisations and institutions.

At the end of December 2014, more than 4 000 individuals had been sensitised or trained in corporate governance. The Institute has a pool of more than 40 trainers who were trained by the Global Corporate Governance Forum (GCGF) of the International Finance Corporation (IFC) of the World Bank. The number of trained personnel tasked with fostering awareness of corporate governance shows a considerable amount of effort; nevertheless, it is disappointing that relatively few people have been trained in the last 15 years (2000 -2015). This suggests that the Institution’s initiatives in corporate governance awareness are not being incorporated into business strategy in most Zambian businesses, because of lack of awareness.

### 2.3.2. Significant Efforts so far

One of the projects undertaken by the IoDZ includes the revision of the Corporate Governance Guidelines for the National Water and Sanitation Council (NWASCO). The Financial Sector Development Plan (FSDP) makes provision for corporate

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<sup>54</sup> ibid 41

governance reforms in the financial sector, by conducting a Corporate Governance status audit, developing a Corporate Governance Code and a Code of Ethics, developing a Curriculum for training directors as well as conducting sensitisation workshops for selected directors. In addition to these projects, the IoDZ has also been involved in the establishment of the FSDP corporate governance reforms in the pensions, insurance sector and capital markets.

## **2.4. CONCLUSION**

This overview of the historical background of corporate governance in Zambia provides a good platform for understanding the prolonged infancy of corporate governance in that country. This overview also provides a suitable introduction to the details of the law and practice of corporate governance in Zambia.

## **SECTION III: LAW AND PRACTICE OF CORPORATE GOVERNANCE IN ZAMBIA**

### **3.1. INTRODUCTION**

Zambian legislation on corporate governance, and particularly the *Zambian Companies Act*, generally aims to provide strong protection to shareholder rights in companies and businesses. To support this legislation, Zambia has corporate governance codes in place such as the Lusaka Stock Exchange Code (LuSE Code), IODZ Corporate Governance Code for Small and Medium Enterprises (SMEs) and the Bank of Zambia Guidelines for financial institutions; all of these provide tools and guidelines on good business practices. Also, Zambia is one of the countries awaiting guidelines from the Organisation for Economic Cooperation and Development (OECD), which is currently working in partnership with governments to develop guidelines for State-owned Companies (SOCs) or State-owned Enterprises (SOEs); the IoDZ has been involved in this initiative from its inception.

Zambian corporate governance is generally regulated by legislation and best practice codes. However, this still raises the question of whether these initiatives and instruments are effective and if so, to what extent? The aim of this section is to use Zambia as a case study to analyse, from an African country's perspective, the challenges associated with compliance and respect for the rule of law, in an effort to see how compliance with the rules of corporate governance can be strengthened.

### **3.2. CORPORATE GOVERNANCE LEGISLATION IN ZAMBIA**

Firstly, it is important to reiterate that corporate governance covers a broad spectrum of issues that cannot easily be addressed in one chapter of the *Zambian Companies Act*. Thus, corporate governance covers the following topics: accounting and auditing; strategic leadership; risk management; integrated reporting; transparency and disclosure; the environment; social impact; and, governance in general. The question therefore should not be: 'should corporate governance in Zambia be an act of

volunteerism or would it be mandatory’ Instead, the question should be: ‘is there a way by which we can strengthen corporate governance structures in Zambia without necessarily prescribing it as legislation order to ensure compliance through effective regulation and enforcement?’

In essence, many of the principles of corporate governance already exist in the law, embodied in various pieces of legislation. Any attempt to expand or grow this legislation will not answer the question of compliance; on the contrary, compliance can best be made effective by enforcing the law.

### **3.3. THE ZAMBIAN COMPANIES ACT - CAP 388**

The artificial nature of a company creates a very specific problem because it does not physically exist, even though it is a legal entity. A company can only function through the medium of the agency of human beings. The two primary corporate organs of a company are:

- (a) General Meetings where members act collectively to make decisions for the Company;
- (b) The board of directors.

It is primarily through these organs that the Company functions. Thus, section 215 (1) of the Companies Act states:

‘... the business of a company shall be managed by the directors, who may pay all expenses incurred in promoting and forming the company, and may exercise all such powers of the company as are not, by this Act or the articles, required to be exercised by the company by resolution.’

Apart from the two organs mentioned above, there are professional managerial organs. The function of the board of directors is of an intermittent basis while the management team carries out the functions of the company on behalf of the board of directors. The board of directors and the managers of companies are expected to also promote good corporate governance practices in fulfilling their roles; these practices include good leadership, accountability, responsibility, transparency, and

sustainability, all as part of the business of the company.

### 3.3.1. Directors' Duties

As mentioned previously, legislation and corporate governance principles often interlock. This applies especially to the basic Zambian law on directors' fiduciary duties, of which the main one is to act in good faith in the interests of the company; this requirement, also known as acting *bona fide*, is the minimum standard expected of a director under Zambian law.

Other duties include the duty to exercise powers for proper purposes, the duty to avoid a conflict of interest, the duty not to make hidden or secret profits, and the duty of applying care and skill. These are the main fiduciary duties indicated in the Zambian Companies act, from where corporate governance principles are supposed to be derived and implemented. However, it could be argued that the Zambian Companies Act is a 'narrow' piece of legislation that only focuses on the company and the protection of shareholders as far as the procedures of a business are concerned. This Act is perceived as relying and focussing mostly on financial reporting<sup>55</sup> for enforcing company responsibility and accountability. The Act does not have a broad based inclusive approach that can take into consideration the different stakeholders associated with the operations of a company; also, there are no specifications for the promotion of corporate governance principles as a requirement under law. Consequently, the LuSE Code can be regarded as weak as it has no legal status.

### 3.3.2. No requirement by Zambian law for independent non-executive directors

One weakness in Zambian company law, making it inconsistent with corporate governance principles, is that section 208 of the Act does not distinguish between the different types of directors; however it recognises that a company can have both executive and non-executive directors. Independent non-executive directors can be understood as: 'able to irrefutably demonstrate their independence; they should be responsible to shareholders; and they should be available to devote the time required

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<sup>55</sup> Half of the Companies Act 388 (Part V to Part VIII) gives a clear illustration of the weakness of Zambian laws in enforcing corporate governance; this Act focuses mainly on the financial aspects of reporting. The Act categorically lays out fiscal legal requirements (Part IV: Shares & Share Capital, Part V: Debentures and Charges, Part VI: Public Issue of Shares, Part VII: Meetings & Resolutions, Part VIII: Accounts, Audit and Annual Returns)

of the role of an independent director.<sup>56</sup> In jurisdictions with advanced codes and legislation on corporate governance, it is a requirement for companies to have independent directors and it is also highly recommended that these directors have specified periods of tenure. A rotation of independent directors should encourage effective performance by the other directors and should promote the much-needed application of corporate governance principles.

One could argue that legal issues on corporate governance can be addressed in different pieces of legislation; for example issues pertaining to the environment would be enshrined in the *Zambian Environmental and Management Act* [2011]. However, the main concern is to determine what needs to be done to ensure that companies and businesses abide by the laws already in place. The levels of compliance have been low, as will be shown in the sections of this thesis that discuss the challenges of compliance and enforcement in Zambia (Section 3.5)

It should be noted that not all principles of corporate governance can be incorporated into law, as some of these are best addressed in Best Practice Guidelines, which are usually adopted voluntarily, rather than prescribed. Legislation is not necessarily the answer as it can only work to a certain extent. Legal cases dealing with corporate governance all address different issues and for every such issue there are different repercussions. These can be civil or criminal repercussions; for example the issue of tax avoidance in Zambia is both a corporate governance principle as well as a criminal offence. One of the solutions could therefore be to apply the law against a background where corporate governance principles and guidelines are highly promoted and championed by legal practitioners, encouraging businesses to improve their application and enforcement.

### **3.4. EXPLORING THE IMPACT OF THE LUSAKA STOCK EXCHANGE CODE ON CORPORATE GOVERNANCE**

The perception that the institutions of corporate governance in Zambia are weak and or inadequate continues to flourish. It is often argued that the notion of corporate

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<sup>56</sup> McCabe, Nowak, 2008, 'The independent director on the board of company directors,' *Managerial Auditing Journal*, 23, 6, 545-566

governance cannot be advanced on the mere basis that the enforcement mechanisms are either weak or non-existent. Any attempt to enforce corporate governance in Zambia, through legislation alone, has clearly proven its limitations, as shown in section 3.3. However, Zambia has created a corporate governance Code under the auspices of the Lusaka Stock Exchange (LuSE), which has been in existence for more than ten years (since 2003). The aim and expectation of this Code is to increase awareness and practice of good corporate governance. A number of similar codes have been drafted in other countries for these purposes. Nevertheless, the effectiveness of these codes, particularly the LuSE Code can only be ascertained by exploring its impact on the market and examining the impact and the role it's played following its introduction.

This section will begin with a brief outline of what constitutes the LuSE Code and will look at its strengths and capacity to enforce and ensure compliance. This will be followed by an examination of the key drivers in the LuSE Code, leading to recommendations on what the ideal code for Zambia should ideally be.

### **3.4.1. The LuSE Code**

Corporate governance codes are intended to assist directors in discharging their legal duties. In the analysis of the Lusaka Stock Exchange Code, below, it is important always to bear in mind that it was written for directors to help them understand their duties. Codes formalise, influence and raise corporate governance awareness and this is meant to influence the investment industry and direct the ways in which participants conduct themselves in the corporate world. One can debate the extent to which these codes are effective. It is from this perceptive that the Lusaka Stock Exchange Code (LuSE Code) will be discussed below.

#### **3.4.1.1. A Principle-based Approach**

In corporate governance, there is a rules-based approach and a principle-based approach for ensuring compliance. A principle-based approach features flexibility; it is not prescribed but is voluntarily opted into by institutions. One may argue that such an approach is more difficult to follow than a rules-based approach which entails mandatory application by 'ticking the requirement boxes' in order to prove compliance. It might seem that a principle-based approach is better as it allows institutions to operate in a '*laissez-faire*' way and as none of the characteristics are

mandatory, this allows for flexibility in application if any changes in the practices arise; it is not necessary to wait for a parliamentary sitting in order to change the law.

The Zambian LuSE Code has a principle-based approach involving ‘comply or explain’, which brings a dynamic aspect to the issue of regulation and enforcement. The comply or explain approach is a *laissez faire* market-based approach in which corporate governance codes and or other regulatory bodies provide for minimum standard requirements from institutions, as opposed to having binding laws. For example, the company management would be required to explain how the principles of the code were applied; if they were not, then reasons for such non-compliance must be given. The LuSE Code is therefore a non-mandatory code but its enforceability is based upon it being a listing requirement as outlined in the booklet titled ‘LuSE Harmonised Listing Requirements of the Lusaka Stock Exchange.’<sup>57</sup> Apart from this, its existence is primarily justified by influencing the investment industry to apply, voluntarily, corporate governance characteristics on a ‘comply or explain’ basis. This approach, however, has certain limitations and these will be discussed below.

#### 3.4.1.2. A toothless mechanism

The disadvantage of a non-mandatory corporate governance system in a country such as Zambia is that voluntary practices to enforce corporate governance would not succeed. Thus, most African countries such as Zambia still need to mature to the stage where self-regulation and enforcement would take place; one obstacle to success is the rampant levels of corruption that surround most business transactions and their operations; here, Zambia ranks 85 out of 175 on the Corruption Index<sup>58</sup>. One could argue that the preferred approach should not be to criminalise non-compliance by having strict laws in place; instead, ‘soft’ laws can be equally effective if well enforced and regulated and these could still maintain the flexibility needed for adapting to the ever-changing business environment. Soft laws as defined by Professor Timothy Meyer can be understood as ‘identifying the chief “legal” characteristic of soft law: the expectation that a non-binding rule will be incorporated into a binding agreement, either as an interpretation of an existing binding rule (at either the domestic or international level), or through the promulgation of a new set of

<sup>57</sup> LuSE, ‘Harmonised Listing Requirements of the Lusaka Stock Exchange,’ <http://www.luse.co.zm/wp-content/uploads/2012/07/LuSE-Listing-Rules.pdf> <, accessed 15 February 2016

<sup>58</sup> *ibid* 24



binding rules...based on the nonbinding rules<sup>59</sup>. In summary, a non-legal requirement placed in a binding document would require compliance if it is part of a binding agreement or understanding.

#### 3.4.1.3. *Listing Requirements*

One of the limitations of the LuSE Code is that it targets a very small number of institutions; this is because its purposes are aimed at companies listed and quoted on the Lusaka stock market. Although the LuSE Code applies to both the public and private sector, it nonetheless targets only a narrow selection of companies; it omits many other market players that are not listed on the stock exchange but still require their corporate governance best practices to be scrutinised and regulated. This latter group of organisations comprises the largest number of players in the business landscape in Zambia. The omission occurs because the LuSE Code only governs listed and quoted companies, which are required by the stock exchange to submit their end-of-year reports within three months of the end of their financial year; those reports must state areas of compliance and non-compliance with an explanation for the latter. Therefore unlisted companies have no obligation to respect or uphold corporate governance policies.

One could argue that corporate governance is only to be enforced by ‘big’ corporates whose environmental, social, community and economic impacts are assumed to be equally large. However this should be seen as a poor argument as there are ‘big’ corporates in Zambia that choose not to be listed and therefore some form of regulation and enforcement mechanism would have to exist to make them comply. This group of corporates includes both local and foreign corporates that usually avoid a local listing on the basis that the company is already listed on a more prominent stock exchange. The question then arises: how do we regulate non-listed companies? Also, how would we ensure that FDI companies comply with corporate governance requirements if they opt out of being listed? How do we regulate our own local businesses that still have a significant impact in the business environment but do not see the need to be publicly listed? This poor attitude of certain companies is costing many African countries, such as Zambia, in terms of growth opportunities and in

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<sup>59</sup> Timothy Meyer, 2009, ‘Soft laws as delegation,’ *Fordham International Law Journal*, 32, 3, 891

terms of attracting more investment and industrial growth. The root cause is the failure to provide an all-inclusive corporate governance system that includes both listed and non-listed companies.

#### *3.4.1.4. Self-Regulation*

The LuSE Code, in common with many well-established corporate governance codes, promotes compliance by relying on self-regulation and there is no mandated or governing institution to ensure enforcement. The current system has no power or authority to require compliance unless the institution in question is a listed company. This is an extension of the ‘listed requirement’ problem, discussed above, that impedes enforcement because only two regulatory acts exist: these only cover the public companies currently listed on the Lusaka Stock Exchange<sup>60</sup> or the financial banking institutions covered by the Bank of Zambia Corporate Governance Code. All other institutions outside these two sectors have no strict regulatory systems. Even the existing systems are weak and ineffective as far as compliance is concerned; this will be demonstrated in later examples.

#### *3.4.1.5. Lack of awareness*

Another limitation of the LuSE Code is the lack of proper awareness of its regulatory and enforcement requirements; this lack of awareness applies especially to the managers of the corporations listed. One can ask whether the average person on the street realises or understands how his or her company should present audit reports according to the LuSE Code. It is stating the obvious to claim that stakeholders should be, and are, the REAL compliance officers but they can only be empowered to act as such if they understand and are aware of what to look out for.

### **3.4.2. Summary of Key Drivers of the LuSE Code**

Corporate governance could be regarded as a performance management and performance judgement system of a company. Taking this into account, a company becomes a complicated operation and the best way to deal with such complexity is to divide the company into parts and to apply corporate governance processes to each part. The application of those processes to complex company situations calls for

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<sup>60</sup> ibid 57

some optimisation and in order to optimise, there is a need for good law and for best practice principles, that are stakeholder inclusive, to be in place.

The LuSE Code identifies nine main drivers of corporate governance and these are as follows:

- a) Board of Directors
- b) Board of Committees
- c) Legal and Compliance
- d) External Audit
- e) Internal Audit
- f) Risk Management
- g) Integrated Sustainability Reporting
- h) Disclosure and Stakeholder Communication
- i) Organisation Integrity

Both the Zambian Companies Act and the LuSE Code exhibit a bias towards the financial aspects of corporate governance, with little evidence of any integrated approach that would take into account the various stakeholders affected by the company.

### **3.4.3 Reviewing specific sections of the LuSE Code**

At the outset, it is important to recognise that the list of key corporate governance structures in the LuSE Code does not include either Ethical Leadership or the Governance of Information Technology Systems (Governance of IT); indeed these have not yet been established in the LuSE Code. One can argue that all the components of the Code are equally important, but ethical leadership should be the fundamental one, at the centre of all issues. Without ethical leadership to enhance good corporate governance practice, the whole Code is futile in the long run. For this reason, this section will put forward a recommendation for the LuSE Code to include both Ethical Leadership and Governance of IT. In addition, selected key drivers identified in the LuSE Code will be reviewed. Suggestions will be recommended for the following key drivers: Board of Directors, Audit Committees, Risk Management and Disclosure and Stakeholder Communication.

### *Ethical Leadership*

One important purpose of corporate governance is to ensure ethical ways of doing business. Reporting, for example, covers regulatory practices underpinned by principles that guide the leadership in a corporation to report honestly on their compliance levels.

Zambia should therefore make efforts to introduce Ethical Leadership into the Code, as one of the drivers; this should require boards to ensure that their companies are seen to be responsible corporate citizens. Leadership must be based on ethical foundations that take into consideration economic, social and environmental impacts in the implementation of company strategies and policies.

The LuSE Code can also require management to cultivate a culture of ethical conduct by taking the following steps:

- Establish an ethics risk profile
- Establish a code of conduct
- Integrate ethics into all company practices, procedures and policies
- Ensure that the company's ethics performance is supported by an assurance statement in an Integrated Report

The requirement of a Code of Ethics is important as it creates guidelines of conduct for a business. More importantly the board must ensure that these ethics are actually integrated in the company's practices.

### *Governance of Information Technology*

The responsibility for IT governance is another element excluded from the key corporate governance drivers in the LuSE Code. This exclusion represents a shortcoming in view of the rapid development of information systems and electronic transactions in the corporate world today. For this reason, responsibility for IT governance should rest with the board and be leveraged to improve performance and sustainability of the company. The LuSE Code should establish IT governance

frameworks to ensure that IT assets are managed effectively; issues include security, information management and privacy. The risk management and audit committees should assist the Board in addressing its IT responsibilities.

### *Board of Directors*

The LuSE Code stipulates numerous corporate governance requirements for the board of directors of listed and quoted companies on the stock exchange. This section focusses on some of the most crucial requirements stipulated in the Board of Directors sector of the LuSE Code.

#### *The Chairman and the Chief Executive Officers.*

The board chairman is expected to be an independent non-executive director. However, the LuSE Code and the Zambian Companies Act do not distinguish between a chief executive officer and a chairman and do not prohibit a situation in which one person fills both positions. This is contrary to the need for division of powers, which is essential for effective corporate governance. Chief Executive and Financial Officers (CEOs/ CFOs) should be treated as contracted employees of the company despite being appointed by the board. By virtue of their position on the board they should vote in their capacity as a director of the company which means that they vote in the best interests of the company as required by a DIRECTOR: they cannot merely represent management and its interests. This issue is not precisely addressed in the Code.

#### *Board Meetings and Board Evaluations*

Other key requirements outlined for the board of directors are that boards should meet at least once a year and must establish benchmarks to evaluate performance.

#### *Director Compensation*

Remuneration of each individual director should be disclosed and the board is expected to have clear transparent policies in place on executive remuneration.

#### *Executive and non-executive directors*

The LuSE Code stipulates the importance of having non-executive directors but does not give precise details of what is expected of them. The Code refers to the issue of a director devoting adequate time to his role and indicates that “adequate

time” shall be determined by the board.’<sup>61</sup> The Code also does not give a precise definition of what is to be understood by ‘independent’ and this is left open to interpretation. This is an important point as the independence of a director serving on the board should be reviewed from time to time to check that his or her independence has not been impaired over time. The silence of the Code on this issue weakens regulations further, as directors and chairpersons in Zambia are known to hold board positions for indefinite periods of time. There are so many gaps in the LuSE Code on the issue of directorship that even issues of conflict of interest within the company are left to the Companies Act to define precisely.

### Audit Committees

Two separate audit committees are mentioned in the LuSE Code: the internal and external audit committee. The Code lays great emphasis on how these two committees should coordinate their work. There are no stipulations concerning the number or qualifications of members that should constitute these committees; this makes the LuSE Code too general and vague although clear guidance is needed. The LuSE Code should add a requirement that audit committee members should, collectively, have an understanding of integrated reporting (including financial reporting) as this is becoming increasingly important in the way annual reports are presented. Audit committees should take into consideration all internal financial controls, external and internal audit processes, corporate law, risk management, sustainability factors, IT Governance and other governance processes. By doing so, they can report holistically on the effectiveness of the company’s financial controls and performance. In addition to this, the audit report should give full description of how audit functions were carried out.

### Internal Auditors

The LuSE Code should also include a provision that an internal audit committee must recommend to stakeholders the appointment, re-appointment and removal of external auditors and should also ensure that the recommended external auditor is approved by LuSE Stock Exchange guidelines. Internal audit should be in a position to provide the board with a written assessment of the effectiveness of the system of internal controls and risk management.

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<sup>61</sup> LuSE Code paragraph 23

### *Risk Management*

The Code indicates that issues of risk governance and key performance indicators, as part of risk management identification, are the responsibility of the board. This responsibility would ultimately include risk management policy and planning, because limits of tolerance are set and should be monitored by the board through the appointment of a risk committee; in practice this function may be assigned to the audit committee. Any risk management reviews or concerns of the company's risk management should form part of the integrated report.

### *Disclosure & Stakeholder Communication*

Disclosure and stakeholder communication is listed as the eighth driver in the LuSE Code; that Code has a very narrow approach to stakeholder communication and this should be expanded on. Thus, disclosure is covered to some degree by the requirement that boards must disclose company details to the stakeholders through the annual report; however, the establishment of formal procedures for communicating to stakeholders is not addressed sufficiently and therefore there is room for expansion. The importance of stakeholder relations should not be overlooked as stakeholder engagement forms the cornerstone of sustainability in corporate governance. Communication with stakeholders should be transparent, simple, and understandable and in accordance with communication standards adopted by the board; also, the board should be encouraged to ensure that internal and or external disputes are resolved efficiently and effectively. The LuSE Code should encourage the board to consider arbitration, mediation and conciliation as alternative dispute resolution (ADR) processes, in place of court proceedings, as ADR is usually more cost effective and efficient in terms of time. ADR has become accepted globally as an important element of good governance as it allows disputes to be resolved efficiently, timeously and effectively taking both parties into account.

However, the limitations of the LuSE Code are not the only challenges in ensuring effective regulation and enforcement. Other challenges exist and with these in mind, this section will now present a discussion of how to deal with foreign direct

investors in a country such as Zambia; real examples are used as case studies to illustrate the challenges surrounding listed and unlisted corporates.

### **3.5. JURISDICTIONAL CHALLENGES AFFECTING ENFORCEMENT OF CORPORATE GOVERNANCE IN ZAMBIA:**

#### **3.5.1 Dealing with Foreign Direct Investments (FDIs): Sweet Nothings**

Action Aid International Zambia recently produced a report entitled ‘Sweet Nothings,’ featuring the activities of Illovo, the South African FDI in Zambia. Illovo is Africa’s biggest sugar producer and also a subsidiary of the global food giant Associated British Foods (ABF).<sup>62</sup> Illovo was operating under the trading name ‘Zambia Sugar’ and had been dealing in tax avoidance schemes through the so-called ‘tax haven’ approach, with countries such as Mauritius, Switzerland and the Netherlands, which are commonly known to host holding companies even though their business operations are in Zambia; the aim was to pay less tax in Zambia<sup>63</sup>. Avoiding tax is a criminal offence under Part IX sections 94 – 97 of the Income Tax Act Cap 323 but at the same time tax avoidance would also fall under the corporate governance principles of Ethical Leadership, Responsible Investing and Integrated Reporting. A weakness in these elements of enforcement is hindering effective regulation and enforcement of corporate governance in Zambia; this will be further illustrated in the subsequent subsections. A strong corporate governance structure in Zambia would help to promote the application of these principles; for example, a detailed annual report would expose loopholes of the type used by Zambia Sugar to avoid paying taxes.

In 2013, Action Aid reported that a street vendor selling the processed sugar produced by Zambia Sugar Nakambala Estates in Mazabuka was paying 4.6% income tax on his or her net income; thus, the average monthly income was ZWK650, 000 of which an average of ZWK 30, 000 per month was paid in income tax. In contrast, Zambia Sugar Company paid 0% tax between 2008 and 2010 despite the average annual net income being ZWK 56, 270, 667, 000, which amounted to approximately

<sup>62</sup> Associated British Foods (PLC), ABF acquired 51% of Illovo – Africa’s largest sugar producer in 2006

[http://www.abf.co.uk/about\\_us/our\\_group/acquisitions\\_and\\_disposals/2006/51\\_of\\_illovo\\_acquired](http://www.abf.co.uk/about_us/our_group/acquisitions_and_disposals/2006/51_of_illovo_acquired)

<sup>63</sup> Action Aid Report:



US \$500, 000, 000. This finding does not imply that the employment that Zambia Sugar creates is of no significance as it gives thousands of employees<sup>64</sup> an income to provide for their families. However, tax revenues can go towards improving infrastructure and providing basic amenities at affordable prices as long as these taxes are channelled back into the Zambian economy.

One of the principles of corporate governance is responsible investing and this requires companies such as Zambia Sugar to be responsible to their consumers, responsible to employees, responsible to their communities and responsible for environmental management in the areas where they operate. Zambia Sugar was making vast profits but at the same time finding ways to shrink its tax bill and by doing so, was avoiding its responsibilities; this is an example of the bad corporate practices that Zambia needs to counter. The solution does not have to be by prescription through the law. Instead the solution probably lies in corporate governance codes as a mechanism of ‘soft laws,’ as opposed to criminalisation.

Nonetheless, the current corporate governance system can be regarded as ‘toothless’ and so both potential solutions present challenges in making multinational organisations, such as the sugar giant, abide by domestic rules and regulations. To begin with, corporate governance principles are not mandatory for companies and businesses that are not listed on the Lusaka Stock Exchange. Any attempt aimed at enforcing and building corporate governance in Zambia will run into difficulties with unlisted companies, as enforceability is only a requirement for the select few listed on the stock exchange.

Furthermore, most multinational companies such as Ilovo, which owns 51% of Zambia Sugar, and many others such as the mining conglomerates operating in Zambia (e.g. Glencore), do not need to be listed on the local stock market. This

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<sup>64</sup> Zambia Central Statistics Office (CSO), ‘2010/2011 Quarterly Employment and Earnings Inquiry Report,’ December 2011, pg. 11 states: ‘Manufacturing industry chiefly includes Zambia Sugar PLC, Food processing firms, Lafarge and several other manufacturing firms across the country. Results show that there was an estimated 55,301 workers in the Manufacturing industry in the first quarter of the 2011, which was 8.8 per cent of all the workers in the total formal sector. With an increase in the number of workers to 57,312 persons in the second quarter, the per cent share of these workers stood at 9.0 per cent.’

presents a problem because these companies can choose to list on other stock markets and not on the Zambia stock exchange. In this situation, the requirement to uphold corporate governance principles becomes a voluntary option while the companies take advantage of some of the stakeholders; this was the case with Zambia Sugar and its employees and the community in which the company operates. This is a clear example of one of the challenges surrounding enforcement and regulation of corporate governance principles in Zambia and most African countries in general.

Most FDIs have their holding companies in other countries and rarely list on the local stock market although Zambia Sugar is an exception. However, this raises concerns over the issue of jurisdiction, which becomes relevant in the event of a dispute or non-enforcement of corporate governance guidelines. Zambia and other African countries should consider promoting corporate governance principles through entry policies or doing business in their country for foreign direct investors. Another option is the incorporation of non-governmental institutions to promote corporate governance compliance, which would make it more attractive for business owners to follow the guidelines. This would also be a way of attracting reputable investors who support the idea of responsible investing.

The counter argument to this recommendation is that FDI may be discouraged in a country such as Zambia if entry is considered to be subject to rigid rules, or too costly, or requiring too much time and effort. Zambia is currently ranked 7<sup>th</sup> <sup>65</sup> on the continent in terms of countries easiest to do business in. It is not surprising to find bureaucracy and red tape in many countries, especially in regulation and enforcement of policy; there is often bribery<sup>66</sup> and cutting of corners to have the paper work

<sup>65</sup> Lusaka Times, 'Forbes ranks Zambia 7<sup>th</sup> best country for doing business in Africa,' 30<sup>th</sup> December 2015 accessed 16 February 2016 < <https://www.lusakatimes.com/2015/12/30/109710/> >

<sup>66</sup> Luming Manzanza refers to corruption and bribery in Africa by quoting Adama Gaye in his paper entitled 'Economic Relations between the Democratic Republic of Congo and China: Legal Framework, current state and perspectives. Thus [Manzanza asks]: "How indeed does one invest in a country where, despite the uproar and the professions of faith of its leaders, everything is an excuse to ask for bribes or ripped off investors? So how can the DRC become an attractive place for investment when you consider how many times the contracts signed were thrown in the trash because such or such official would not find his account at the top of the State officer or his protégé has found a more attractive offer in terms of commissions, we question ourselves after Gaye'

completed in a reasonable time. Zambia needs to be seen as business-friendly and therefore should avoid stringent regulations and policies in setting up a company or doing business.

Moreover, the relative ease of doing business on the African continent has brought in new dynamics and risks, with the influx of Chinese investments into Zambia and Africa as a whole. These dynamics and risks stem from a lack of appropriate and strong regulatory and enforcement mechanisms of corporate governance; therefore, countries tend to lose more than they gain from the long-term presence of enormous Chinese investments on the continent.

### 3.5.2. Dynamics and risks around Chinese Investment and possible short-term gain from exploitation

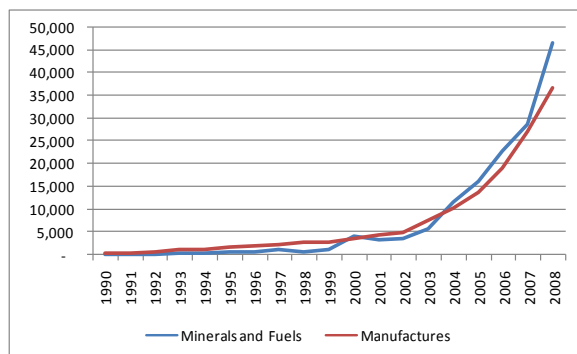
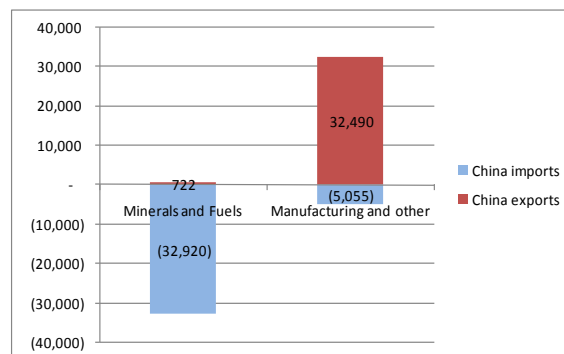
*'The dramatic rise of China has stopped the process of marginalization of Africa in world trade.'*<sup>67</sup>

China's presence on the African continent can no longer go unnoticed. China increased its imports into Africa from US\$5.3 billion in 2000 to US\$38.8 billion in 2009. Exports increased from US\$3.5 billion in 2000 to US\$33.2 billion in 2009.<sup>68</sup> Figures 2.1 and 2.2, below, illustrate an increase in Chinese foreign direct investment which countries such as Zambia have not adequately prepared for, in terms of how to accommodate these investors and hold them accountable in their corporate dealings on the continent.

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<sup>67</sup> Jean-Raphael Chaponnière, April 2008, Chinese aid to Africa: origins, methods and challenges, *The Political Economy* 038

<sup>68</sup> World Bank, January 2011, 'Chinese Investments in Special Economic Zones in Africa: Progress, Challenges and Lessons Learned,' 31

Fig. 2. 1 and Fig 2.2<sup>69</sup>**Figure 2.1: Total trade (imports + exports) between China and Africa in 1990-2008 (US\$ mn)****Figure 2.2: Chinese trade balance with Africa in 2009 by sector (US\$ mn)**

Source: Bräutigam, Farole and Tang (2010).

Many of the large Chinese corporate activities are politically affiliated as Chinese investors have seen the gap presented by African leaders; that gap is in infrastructure building<sup>70</sup>.

African governments, when contracting with Chinese businesses, should have firm legal, regulatory and corporate government structures in place in order to command application and enforcement by the Chinese investors. There are a large number of Chinese FDIs in Zambia, involved in road construction and a broad spectrum of infrastructure construction; in most cases the contracts are probably more generous and lenient than they would receive as an investor in their home country, China itself. More often than not, the infrastructure developmental projects given to Chinese investors appear to short-change the African host country. Luminguh vehemently expresses his views using the Democratic Republic of Congo as an example on this topic, by illustratively expressing the common perception of road construction handled by Chinese investors in most African countries by stating the following:

The consequence is that where Western companies are building roads designed for long life, the Chinese are building roads [that are] less sophisticated that cracks are easily perceived the same day of the official opening. And behind this sad state lie[s] several realities: the Chinese offer their services at an affordable cost for the Congolese, this is an open secret, but the bribes and commissions constitute the hidden part of

<sup>69</sup> ibid 67

<sup>70</sup> ibid 67 p.g.77

the iceberg.’<sup>71</sup>

It is therefore important for African governments to require a skills transfer policy, environmental protection, corporate social responsibility as well as respect for the rule of law and financial regulations. The host government should do this as part of their ESG requirements. By doing this, the community in which the Chinese FDI is operating in and making a return, also benefits both indirectly and directly. This benefit is not only in terms of the infrastructure development but also in terms of other deliverables such as job creation, protection of the environment, water and sanitation as well as waste management in the community. This gives the local community and other stakeholders a sense of trust and transparency, as the Chinese are conscious of the need to invest responsibly even as they aim to make a profit. Social and environmental impact management strategies are a prerequisite for sustainable development and are needed to earn the trust and support of the surrounding community. This is a corporate governance principle that all businesses, whether local or an FDI, should abide by.

This discussion should not suggest that the issues are confined to FDIs operating on the continent. The same concerns apply to local businesses, and perhaps even more so than to the foreign direct investors; after all, these local businesses and companies in Zambia are rarely listed on the stock exchange and therefore any attempts at enforceability and regulation of their corporate governance operations are almost non-existent. However, even listed companies pose challenges. An example will be presented, in the next section, using a listed Zambian company, to show that regulation is difficult and enforcement is equally difficult regardless of whether an FDI or a local company is involved.

### **3.5.3 Dealing with a Local Enterprise: The Case of Zambeef**

A locally-based company provides an example to show that the challenges of enforceability and regulation of corporate governance are not confined to foreign direct investors; on the contrary, the challenges apply ‘across the board.’

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<sup>71</sup> ibid 67

### *A Meaty Scandal*

During 2013, meat scandals were unearthed in different parts of the world. While Europe was coming to terms with horse meat being displayed as beef on the shelves,<sup>72</sup> Zambia was dealing with accusations that Zambia's leading meat producer, Zambeef, had sold meat containing unacceptable quantities of the chemical Formaldehyde (aromatic aldehyde) in the meat.<sup>73</sup> This chemical is generally used for preservation, but is 'not for human consumption',<sup>74</sup> as stipulated by the Zambian minister of health at the time, Dr. Kasonde. It is also used in embalming human corpses for preservation. It should be understood that Zambeef was actually reluctant to admit to these accusations despite the widespread media frenzy, both on social and print media, that reported the issue. An operational update on their website during the scandal indicated that they would wait until confirmation through the laboratory test results.<sup>75</sup> There appeared to be a criminal breach of the law through the abrogation of the Zambian Public Health Act Cap 295 and the Food and Drugs Act Cap 303. The question now arises: what does this have to do with corporate governance?

Corporate governance as defined in Section I of this paper is a 'system of checks and balances, to ensure compliance with legal and regulatory obligations, a risk management process, accountability to stakeholders.'<sup>76</sup> Therefore the principles of corporate governance apply to health, food and safety, responsible investing, and accountability to the community: the meat consumers in this case. Those principles also apply to the creditors and employees who may suffer by virtue of management's decisions if those decisions lead to a loss of jobs and revenue attributable to diminished trust and transparency by the market. Therefore, from this point of view, the Zambeef meat scandal did not just break the legal rules but also broke corporate governance principles, despite Zambeef being a listed company on the LuSE stock

<sup>72</sup> The Guardian Newspaper, 'Horsemeat scandal, the essential guide,' 15 February 2013. Accessed 17 February 2016 < <http://www.theguardian.com/uk/2013/feb/15/horsemeat-scandal-the-essential-guide> >

<sup>73</sup> Lusaka Times, 'Tests confirm Aldehydes in Zambeed meat, Government to take action against firm,' 18 July 2013 < <https://www.lusakatimes.com/2013/07/18/tests-confirm-aldehydes-in-zambeef-meat-government-to-take-action-against-firm/> >

<sup>74</sup> The Post Newspaper, 'Food Business Africa, MoH has evidence of aromatic aldehyde in Zambeef meat,' 29 June 2013 < [http://www.foodbusinessafrica.com/index.php?option=com\\_content&view=article&id=250:moh-has-evidence-of-aromatic-aldehyde-in-zambeef-meat-2&catid=89&Itemid=484](http://www.foodbusinessafrica.com/index.php?option=com_content&view=article&id=250:moh-has-evidence-of-aromatic-aldehyde-in-zambeef-meat-2&catid=89&Itemid=484) >

<sup>75</sup> Zambeef Products PLC, 'Operational Update,' 20 July 2013

<sup>76</sup> *ibid* 2

market and the London Stock exchange; its listing requirements stipulated that businesses and companies must follow the corporate governance guidelines.

The challenge with local business, particularly in Zambia, is that of regulation. This applies even though the relevant rules and standards have been set: this is evident from the previous example of the behaviour of a listed company. One can only imagine the extent to which non-listed companies are not aware of what is expected of them. Also, these corporate governance principles are not a mandatory requirement unless companies freely choose to apply them, and this poses the main challenge. Regulating essential principles without the authority to require compliance and the means to ensure enforcement by business clearly illustrate a toothless mechanism that cannot help regulation and promotion of corporate governance. It is from this perspective, using Zambeef's meat scandal as an example, that the weakness of enforcement of corporate governance in Zambia can be seen.

#### **4 CONCLUSION**

To summarise: the examples of FDIs on the continent and in Zambia in particular, as well the examples of local businesses, show clearly that the challenges of promoting corporate governance lie in improving the current toothless mechanisms of enforcement and regulation; these mechanisms need to be revisited.

Recommendations and suggestions on how to strengthen these mechanisms are discussed in section V of this paper.

## SECTION IV: COMPARATIVE ANALYSIS OF COMPLIANCE (REGULATION AND ENFORCEMENT) APPROACHES TO CORPORATE GOVERNANCE

### 4.1. INTRODUCTION

The issue of compliance in corporate governance ‘is a significant issue, not always afforded the significance it deserves.’<sup>77</sup> It is fundamental as non-compliance makes the whole notion of governance ineffective and pointless. There are different approaches towards fostering compliance; ‘apply or explain,’ ‘comply or else’ or the ‘comply or explain’ approach. An examination of these approaches is of great importance as this is one way of finding the most effective one; a method of comparative analysis is applied.

It is apparent that all three approaches have been tried and tested in different countries; for example, the United States of America’s approach is ‘comply or else’ with the threat of legal sanctions for non-compliance.<sup>78</sup> The United Kingdom (UK) uses ‘comply or explain’ and South Africa uses ‘apply or else.’ The fact that each of these countries can generally boast of overall positive compliance rates leads one to conclude that the effectiveness of these approaches is relative and specific to the business environment in which they are enforced. In order to illustrate this, this paper begins with an introduction to the South African approach of ‘apply or explain’ and looks at the historical evolution behind this approach. Secondly, a method of comparative analysis is used to assess the effectiveness of the South African approach and the American and UK approaches are contrasted and compared. By doing so, the strengths, weaknesses, similarities and differences of each approach are highlighted.

Thirdly, this paper will draw on the principles of responsible leadership outlined in the corporate governance case, *SABC Ltd v Mpofu* [2009] and the importance of participation of all stakeholders in addition to the preferred mandatory

<sup>77</sup> L Boule, ‘Globalization and Governance’ 1<sup>st</sup> ed (2011)

<sup>78</sup> King III, South African Corporate Governance Code, Introduction



approach. These two factors are essential for the effectiveness of the *n'importe quelle*<sup>79</sup> approach.

## 4.2. SOUTH AFRICA

### 4.2.1 'Apply or Explain'

South Africa's current approach towards ensuring compliance with corporate governance principles is that of 'apply or explain,' which has evolved from 'comply or explain.' The different approaches might appear to be a game of semantics but they are the outcome of a great deal of debate. In order to understand the choice behind this 'apply or explain' approach, one must look backwards briefly at the evolution of South Africa's Corporate Governance Codes. Following the formation of the first South African Institute of Directors (IODSA), the first King Code (King I) was formed in 1994 followed by King II in 2001. The period between 2008 and 2009 brought about many changes to the world of financial and business regulation and the South African Companies Act 71, coincidentally, was also being reviewed at that time. IODSA revised its Corporate Governance Code, releasing the latest, King III (2009) which was highly influenced by these events. Firstly, King III was compatible with the New Companies Act and was drafted with that Act in mind. It was also seen as a way of putting new regulatory measures in place in an effort to avoid another financial crisis like the one of 2008. The Johannesburg Stock Exchange (JSE) produced new mandatory listing requirements<sup>80</sup> that included the compulsory application of King III. Another significant change was that King III adopted a wider approach in terms of application. This background sheds some light on the evolution from 'comply or explain' to 'apply or explain.'

This 'apply or explain' approach is principally driven by recommendations, which can also be referred to as 'soft laws,' rather than hard, mandatory, statute-based laws. The approach is also supported by former ESKOM chair, Reuel Khoza, who states that 'self-governance is more effective than imposition that is instigated by law.' Furthermore, one can argue that some of the strengths of that approach are as follows: those who apply the principles are more engaged and comfortable with

<sup>79</sup> N'importe quelle – French for 'no matter which' approach

<sup>80</sup> JSE Listing Requirements: paragraphs 7.F.5, 7.F.6 and 8.63(a)

compliance because ‘if it [the board] believes it is in the best interests of the company, to override a recommended practice’<sup>81</sup> it can do so provided it has an explanation; this is in contrast to having a ‘mindless response to corporate governance,’<sup>82</sup> or a ‘tick box mentality’ that is most likely to manifest in a ‘comply or explain’ or ‘comply or else’ approach. Furthermore, it is also believed that the flexibility provided by this approach fosters innovation, creativity and risk taking, which are necessities in the business world, as opposed to the rigid rules of mandatory compliance.

Nevertheless, King III still stipulates the importance of the law in terms of ensuring effective compliance, by stating that ‘good governance is not something that exists separately from the law and it is entirely unnecessary to unhinge governance from the law.’<sup>83</sup> This statement leads to the debate about the point of having corporate governance codes rather than mandatory laws. After all, laws may be more effective in achieving good corporate governance because legal sanctions can accompany any default with no excuses or explanations accepted: comply or else! Despite South Africa’s corporate governance system of ‘apply or explain’ being an internationally acclaimed one, it has a weakness. Thus, it lacks sufficient ‘teeth’ to ensure implementation, enforcement and compliance. The Johannesburg Stock Exchange (JSE), alone, is not sufficient, since its mandate only applies to listed companies. However, one should not rule out the prospects of success of a self-regulatory system when there is a similar system in the UK that also relies on the market, financial regulatory bodies, and the London Stock Exchange (LSE); this system is working fairly well as will be shown in the succeeding paragraphs.

By using a method of comparative analysis, the second part of this section will assess the effectiveness of the South African approach, compared with the UK and American approaches. This will show the strengths, weaknesses, similarities and differences of each approach.

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<sup>81</sup> King III, Code of Corporate Governance for South Africa, 8

<sup>82</sup> FHI Cassim, MF Cassim, R Cassim, R Jooste, J Shev and J Yeats, 2011, *Contemporary Company Law*, 1<sup>st</sup> ed., 434

<sup>83</sup> King III, Code of Corporate Governance for South Africa: The link between governance principles and law,’ 6

### 4.3. UNITED KINGDOM

#### 4.3.1 ‘Comply or Explain’

The United Kingdom applies its corporate governance principles using a ‘comply or explain’ approach. South Africa and the UK may be similar in the sense that both their approaches are based on self-regulation and therefore compliance is largely left to the market to regulate. However, it could be argued that the self-regulatory environments in which South African and British businesses and companies operate do differ from each other. The UK has more than just a stock exchange (LSE) to implement and ensure compliance with corporate governance principles; this is unlike South Africa, which heavily relies on the JSE. Other external independent regulatory bodies such as the Financial Reporting Council, Financial Services Agency (FSA) and the UK Listing Authority (UKLA) provide muscle because compliance or application reports are required by these institutions as well: failure to do this results in penalties.

Recent research from the University of Newcastle’s ‘flower eye test’ suggests that ‘people behave differently when they are being watched... [it] affect[s] people’s tendency for social co-operation in a real-life setting.’<sup>84</sup> Such observations support the argument that people applying the principles of corporate governance are more likely to co-operate and comply under mandatory laws or closely supervised self-regulation mechanisms, when institutions are in place like those in the United Kingdom. This arrangement is better suited for the UK and perhaps for South Africa, to a certain extent, if it had to strengthen its regulatory institutional capacity. This situation would probably apply in most African countries, where economies are rampant with high levels of corruption and are far from being able to let the market regulate itself. Here, one can recall the point, made previously, that the effectiveness of these approaches is relative and depends on the various factors in the specific business environment. Nonetheless, it is useful to look at the benefits and disadvantages of each approach. Thus, the ‘comply or explain’ approach, in common with South Africa’s ‘apply or explain’ provides for a great deal of flexibility in terms of responding quickly to crises and events, rather than having to wait for a bill to be passed in parliament to become a statute and thus enforceable.

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<sup>84</sup> Newcastle University, ‘“Big Brother” eyes encourage honesty, study shows,’ 27 June 2006 [http://www.eurekalert.org/pub\\_releases/2006-06/uonu-be062606.php](http://www.eurekalert.org/pub_releases/2006-06/uonu-be062606.php) <accessed 15 February 2016>

## 4.4. UNITES STATES OF AMERICA

### 4.4.1 ‘Comply or else’

The United States of America applies the ‘comply or else’ approach, which provides clear laws and guidelines that can be enforced by legal sanctions that accompany these laws. It is accepted that there is much scope for flexibility and freedom in self-regulation; however, it could be argued that the effectiveness of the notion of self-regulation is overrated and puts so much faith in the idea of the corporate citizen a topic of great debate.

Mervyn King, the doyen of South African corporate governance seems to have great faith in the intrinsic goodness of people, because believes that laws are not needed *per se*. Thus, he writes in *Transient Care Takers*: ‘regulators need pass no law other than each company has to explain its conduct with regard to corporate social responsibility.’<sup>85</sup> It is accepted that there are many genuine people and companies with good intentions in the world. However, the opposite is also true especially in the world of business where a company’s growth usually depends on getting ahead of others. This competition and drive to get ahead and make substantial returns and profits will probably provide the setting for creative excuses and explanations in the ‘comply or explain’ and ‘apply or explain’ approaches; this makes any system based on those approaches ineffective and therefore pointless.

Legislators should consider prioritising issues of corporate governance in order to speed up the response time to events and possible crises; this will provide for flexibility that self-regulation encompasses. The ‘comply or else’ model, in this writer’s opinion, would be the better option for most developing countries in Africa, at least at the outset; it could perhaps gradually develop into a self-regulatory system when the business environment in those countries is mature enough to withstand at least three quarters of the current corruption levels. Without this transformation, ‘comply or else’ would be the preferred and most effective choice.

<sup>85</sup> M King and T. Lessidrenska , 2009, ‘*Transient Care Takers: Making Life on Earth Sustainable*,’ Picador Africa, 184

#### **4.5. THE ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD)**

The OECD provides a global, international benchmark for corporate governance. This can be used as a guide by countries, helping them to draw up their own governance systems, taking into account the unique characteristics of the business environment of each particular country. The OECD guidelines are often referred to as the hybrid model as the OECD created a corporate governance model that can be implemented in different formats and regions of the world but with a specific mission: to promote corporate governance. The OECD emphasises the need for corporate governance codes and guides to be consistent with the rule of law in order to be effective.

Although the OECD has produced various guidelines on the topic of corporate governance, this section examines the question of whether ascertaining accountability of various institutions should be done through the ‘comply or explain’ or ‘apply or explain’ mechanism. This is followed by an evaluation of what would need to be done to ensure compliance by institutions that are government owned.

#### **4.6. CONCLUSION**

The purpose of corporate governance is ‘to ascertain or assist directors on whether they have discharged their duties.’<sup>86</sup> Therefore, the effectiveness of any of the ‘apply or explain,’ ‘comply or explain’ or ‘comply or else’ approaches rests on the principle of responsible leadership. Applying or complying with principles of corporate governance requires responsible leadership. This issue is clearly described in the case of *SABC Ltd v Mpofu* [2009] as leadership, which is ‘characterised by ethical values of responsibility, accountability, fairness and transparency which values underpin good corporate governance.’<sup>87</sup> The introduction of more legislation in the absence of responsible leadership will not help the advancement of ethical values; this was pointed out in *SABC v Mpofu* [2009]. However, participation by all stakeholders would promote better effectiveness of all these approaches. For example, the passive shareholders could clearly stipulate to the institutional funders that they should invest their money in companies or businesses that uphold sustainability and corporate

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<sup>86</sup> *ibid* 6

<sup>87</sup> *South African Broadcasting Corporation Ltd (SABC) v Mpofu* [2009] 4All SA 169 (GSJ)

governance principles. This would indirectly influence the boards and management of these companies to run their businesses in a sustainable and accountable manner in order to build credibility to attract investors. In addition, employees and the community at large need to build a strong civil society to demand responsible investing and responsible leadership. In the Conclusion of this report it will be recommended that all stakeholders be incorporated into the Lusaka Stock Exchange Corporate Governance Code.

## SECTION V: CONCLUSION

In conclusion: it is clear that the preferred approach would be that of ‘comply or else’ but in conjunction with participation of all stakeholders: these include the passive shareholders, the board, management, employees and the community. All of these need to be governed by responsible leadership. However, this paper has also shown the complexities of evaluating the effectiveness of the different approaches of ‘apply or explain,’ ‘comply or explain’ and ‘comply or else,’ in order to ensure compliance. Thus, each of these approaches has to be evaluated within the context of the specific country or jurisdiction; it is evident that one approach may work well in one country but may not necessarily be effective in another.

### 5.1. RECOMMENDATIONS FOR ZAMBIA

The notion of stakeholder inclusivity has been part of the global evolution of corporate governance. ‘Stakeholder inclusivity’ is a term describing a broader and more inclusive process of communication between a company and those potentially affected by it. The current view is changing from just looking at shareholders as the only and or main stakeholders; instead, a broader perspective is applied that includes employees, trade unions, consumers, financial institutions, suppliers and communities. Zambia and other African countries developing their corporate governance structures need to recognise the importance of the stakeholder inclusivity approach. In particular, the various stakeholders need specific reassurances and accountability frameworks; for example, concerning job safety (e.g. employees), financial reporting (creditors) and environmental issues (consumers/ the community).

#### 5.1.1 Where we are now

At present, the notion of stakeholder inclusivity is accompanied with much oversimplification in Zambia because there is still a slight disconnect between the theory and the reality. Companies are under pressure from shareholders to maximise returns on investment capital but at the same time shareholders feel their rights are being eroded at the cost of competing claims of other stakeholders concerning issues of the environment, sustainability, and the like. The debate can become heated because the cost of compliance is of great significance, which in itself is an issue.

This is the argument that people in decision-making positions put forward to explain why stakeholder inclusivity does not necessarily appeal to them. Thus:

The first challenge involves identifying exactly who the stakeholders are, developing policy on how they should be engaged – and how you report back. The reality is that the shareholders still own the company and they want a return on their capital, but not at *any* price.<sup>88</sup>

Nonetheless, the future looks bright.

### 5.1.2. The need for Stakeholder Inclusivity

It is clear that there is a need for a stakeholder inclusive approach; after all, it is not a good approach to have a narrow focus on just marginal profits and nothing else. The business world is part of society as a whole and therefore the way in which a company or business operates has to take into consideration other factors such as ESGs (Environmental, Social and Governance issues). One can cite many examples of companies that did not do this; for example, the 2010 Deep-water Horizon oil spill popularly referred to as Gulf of Mexico BP oil spill,<sup>89</sup> the effects of which will be felt for many decades to come not only on the marine life but on the shareholders, community and environment around that area. Another example is that of the global financial crisis. There is enough evidence to show that the need for corporate governance and stakeholder consideration and inclusivity is of paramount importance in order to avoid such calamities. Shareholders should therefore be asking their company directors the right questions and should be ensuring that the right checks, balances and precautions have been put in place to avoid such mishaps. Ignoring a broader stakeholder approach could lead a company into a disaster that could even cause a global crisis: the global financial crisis of 2008 illustrates this. It is therefore evident that there is an over-riding need for a stakeholder inclusivity approach.

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<sup>88</sup> Wilkinson, 2012, echoed these sentiments and expressed the challenges in changing the mind-sets of boards in order to take stakeholder issues into account.

<sup>89</sup> The Guardian Newspaper reports that British Petroleum (BP) continued to make a \$6.3bn quarterly loss between 2010 and July 2015, showing the continued effects not only on the environment but also on the creditors (shareholders) [<http://www.theguardian.com/business/2015/jul/28/bp-loss-deepwater-horizon-bill>] and the employees who still suffer job losses five years after to this disaster [<http://www.theguardian.com/business/2016/feb/02/bp-annual-loss-biggest-for-20-years-axes-thousands-of-jobs-deepwater>].



### 5.1.3. The need for a revision of the current *Zambian Companies Act*

In order to strengthen the regulation and enforcement of corporate governance in Zambia, there is an urgent need to review the Companies Act. This is an out-dated Act although it may still be useful in many ways. Nevertheless it needs to be updated to respond to the modern developments in the corporate world and particularly in the area of corporate governance today; the update would need to take into consideration the different facets of compliance such as respect for the environment, social implications as well as financial creditors, amongst others. Reviewing the Act should ensure that it becomes one of the instruments available for effective enforcement and regulation, within the ambit of the rule of law. Every institution would have to abide by it, and failure to do so would cause repercussions as defined for that specific breach. In addition to the revised Act, other forms of soft laws can be recommended as a mechanism of fostering the approach of ‘comply or else’ for maximum compliance.

#### *Proposal to Introduce soft laws as a support to the *Zambian Companies Act* Cap 388 to ensure compliance*

One could argue that the elements of corporate governance elements are not all addressed in one single Act; instead, they are covered, often individually, in different pieces of legislation. In any case, there is not necessarily a need for new laws to ensure compliance; instead there is a need for enforcement of existing laws. Indeed, compliance is the main problem, which is why it is a topical point of discussion today on the subject of corporate governance enforceability.

The proceeding section strongly advocated for stringent consequences, laid down by the law, to ensure compliance; however this may not be the only approach. There are various ways of promoting enforceability of corporate governance principles and the regulation of this enforcement. This section presents some proposals to this effect and in no particular order the following will be discussed as recommendations: integrated reporting in Zambia, stakeholder inclusivity, responsible investing and the general need for the revision and update of the *Zambian Companies Act*.

#### 5.1.4. The need to introduce, support and promote the concept of integrated reporting in Zambia

*“Corporate reporting as we’ve been doing it for the last decade is no longer fit for purpose<sup>90</sup>” (King, 2012a)*

Having discussed the need for stakeholder inclusivity and revision as the first and second recommendations, as a third recommendation, the concept of integrated reporting should be introduced, supported and promoted by Zambian institutions in charge of corporate governance. This concept encompasses a holistic structure of how business strategy should be approached today. Countries such as South Africa have played a leading role in establishing the concept of integrated reporting and this has led to a major change in corporate reporting in South Africa; institutions are now being more responsible and accountable both in the public and private sector.

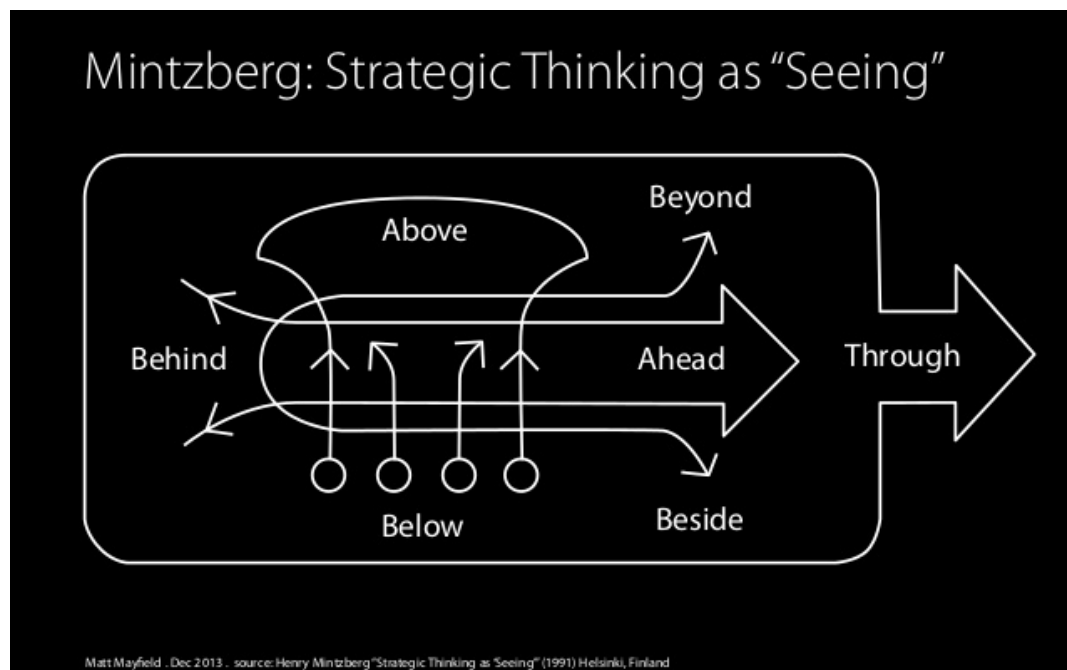
In order to understand the need for integrated reporting in Zambia one needs to consider the International Integrated Reporting Council, as a guide to how this recommendation could benefit corporate governance in Zambia. Subsequent to the 2009 King III Report, the Integrated Reporting Council of South Africa was formed in May 2010. This was followed by the International Integrated Reporting Council (IIRC), which was established by a team led by the South African doyen of corporate governance, Professor Mervyn King in July 2010. The IIRC is still known as the global authority on integrated reporting and its mission is to include integrated reporting in mainstream business practice in the public and private sectors. This mission consequently led to the release of the guideline document titled ‘Integrated Reporting <IR>Framework (FW)’ in December 2013<sup>91</sup> as a way of changing the way business and reporting is done. It represents a transition from the past, which focused on financials, to the present focusing more on the operations of a business as a model, which is more aware of the none financial, issues surrounding the company and how the business can be kept more sustainable.

<sup>90</sup> Mervyn King in a key speech at a high-level meeting of investors hosted by Prince Charles at St James’ Palace in 2009

<sup>91</sup> The International Integrated Reporting Council, December 2013, ‘The International Framework,’ IIRC, Ch. 3., 16

In summary, IR Frameworks serve as guides as far as the ‘triple bottom line’ (Environment, Social and Governance) issues are concerned. These Frameworks show how to take these issues into account: people involved in the business strategy of a company synchronise all facets of an organisation together with the financial aspects of reporting. The concept of integrated reporting therefore addresses the integration of strategy, sustainability and governance<sup>92</sup>. Bob Garratt makes reference to Henry Mintzberg’s model as illustrated in an image in his book, *‘The fish rots from the head: Developing effective boards,’*<sup>93</sup> explaining this concept well. Thus, as part of integrated thinking, integrated reporting should be able to see ahead, behind, above, below, beyond, beside and finally see through it all (refer to Fig.3 below). Basically, seeing strategy holistically involves taking into account all the stakeholders involved, and those affected by the business, when thinking, planning and being accountable in reporting.

<sup>94</sup>Fig.3. Strategic thinking as ‘Seeing:’ Henry Mintzberg



<sup>92</sup> Institute of Directors Southern Africa, July 2013, KPMG, Audit Committee Forum, ‘Integrated Reporting: gathering momentum and taking shape’

<sup>93</sup> Garrat. B, 2010, *‘The fish rots from the head: Developing effective boards,’* 3<sup>rd</sup> edition, Profile Books

<sup>94</sup> ibid 63

Against this background, the introduction of integrated reporting is highly recommended as a way of ensuring enforcement and regulation of corporate governance. With the increase in the number of FDIs entering the business space in Zambia and Africa as a whole, the governing authorities need to demand that integrated reporting is paramount in the requirements of corporate governance principles. This will help to promote effective regulation by ensuring that companies think through their business strategies from inception to completion. Companies must not only look at how the strategies will make them more money; they must also look at what impact (positive or negative) their operations have on the community they operate in and how they can plan for this. Chapter 9 of King III, which lays out the practice notes for integrated reporting, explains the primary source of integrated reporting as follows:

To explain to providers of financial capital how an organisation creates value over time. In other words, when deciding on what gets included in a report it is what substantively affects the organisation's ability to create value over time; with the providers of financial capital serving as a "filter" of information. The FW states that this report benefits all stakeholders interested in an organisation's ability to create value over time.<sup>95</sup>

Professor Mervyn King's quote at the opening of this section 5.1.4 goes on to emphasise that the previous reporting focus on financials was '*no longer fit for purpose*'<sup>96</sup> and companies needed to take a broader look at their responsibilities and at being effective, by responding to issues in their integrated reports as part of their strategies. Once this viewpoint is introduced and adopted in Zambia, Zambian corporate governance will create integrated performance and thinking. However one prerequisite is to establish a policy requiring companies to submit holistic overviews of their operations explaining how these operations are sustainable and add value to the benefit of all stakeholders. The OECD's 2014 background paper for the 30<sup>th</sup> Round Table Report on Sustainable Development summarises what is meant by 'integrated thinking' as follows:

The active consideration by an organization of the relationships between its various operating and functional units and the capitals

<sup>95</sup> King III, 2014, 'Practice Notes,' Institute of Directors in Southern Africa, 3

<sup>96</sup> *ibid* 71

that the organization uses and affects. Integrated thinking leads to integrated decision-making and actions that consider the creation of value over the short, medium and long term.<sup>97</sup>

Integrated reporting seems to be a good way of ensuring that companies are law abiding and that they implement good corporate governance; however, it poses challenges. The subsequent sections will highlight some of these challenges in integrated reporting, in no particular order: additional responsibilities; greater liabilities on directors; and, challenges in choosing the right sectors to report on.

### *Challenges of Integrated Reporting I: Additional responsibilities*

Integrated reporting imposes additional responsibilities that call for integrated thinking, reporting and stakeholder engagement. Annual reports need to include this information and are therefore more bulky than previous ones. The problem arises in trying to ascertain whether anybody actually reads, word-for-word, the 400 page plus documents produced today in the name of integrated reporting reports. In view of this, would a follow-through recommended process actually take effect as far as the primary purpose of integrated reporting goes?

### *Challenges of Integrated Reporting II: Greater liability on the shoulders of Directors*

One could argue that another challenge of fostering enforcement of corporate governance, through the introduction of integrated reporting, would be that of the increase in liability of directors. It is widely felt that liability cover for directors should not increase. One counter argument is that if directors plan their roles properly, then the management risks would decrease, both for individual directors and the organisation as a whole; therefore there should be no need to worry about added liability.

### *Challenges of Integrated Reporting III: Choosing the right issues to report on*

One of the key challenges surrounding integrated reporting is that of the bulkiness of integrated reporting, particularly the issue of losing focus on being concise in reports. This could eventually lead back to a ‘tick box approach’ that

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<sup>97</sup> Baron. R, 2014, Background paper for the 30<sup>th</sup> Round Table on Sustainable Development, ‘The Evolution of Corporate Reporting for Integrated Performance,’ OECD, 7

should be avoided in corporate reporting. The South African Director of Public Prosecutions (DPP), Mxolisi Nxasana argues that integrated reporting could actually be less effective if useful information is lost in a mass of detail. At the same time, it is important not to lose sight of the purpose of the document. Zambia and the Lusaka Stock exchange (LuSE) in particular, should keep in mind during the review of the corporate governance code that an integrated report needs to be concise and focus on its primary audience: the investors. Only by doing so will it achieve its purpose of fostering effective enforcement and regulation of corporate governance requisites.

The benefits of integrated reporting greatly outweigh the challenges presented here. However these challenges have been outlined to keep them in mind in the event of possible queries that may arise during the presentation of the concept to corporates operating in the Zambian business sector.

#### **5.1.5. The Need to Advance Responsible Investing in Zambia**

Responsible Investing (RI) is an important and necessary mechanism for promoting sound governance principles and practices within companies because it holds directors and management accountable. Zambia needs to promote and encourage investors to invest responsibly. Responsible investing is a key governance driver and it has been referred to as the missing piece in the puzzle as far as South African corporate governance is concerned. Thus, the King Code does not provide an adequate platform to address issues of responsible investing, which have now been enshrined in a supplementary Code known as the Code for Responsible Investing in South Africa (CRISA). The LuSE Code should also add a similar provision for RI as it is a crucial element in ensuring compliance and the success of corporate governance. This addition will provide guidance to investors who may need to ask businesses and companies key questions on their ESG principles and policies, as well as risks, before injecting in their money. This will ensure that long-term investments are sustainable, bearing in mind that large sums of capital are injected and put at risk.

#### ***Doing away with Passive Investors***

Engaging investors to help in the enforcement of corporate governance practices is another way of ensuring the advancement of these practices in the corporate world. The concern is that there is not enough being done to attribute

responsibility and accountability to people conducting business transactions. There is also a need to ensure transparency in dealings. This situation has led to the United Nations launching country guidelines on responsible investing, known as Principles of Responsible Investing (UN PRI). The UN PRI focuses on promoting six principles of responsible investing centred on environmental, social and governance issues on the premise of advancing corporate governance. The goal of the UN PRI is ‘to understand the implications of sustainability for investors and support signatories to incorporate these issues into their investment decision making and ownership practices.’<sup>98</sup>

Zambia would do well to be guided by these policy guidelines and to adapt them to the business environment of the country. This would help ensure that capital injectors (investors) are well aware of their responsibilities as well as the powers they have at their disposal to become active owners of capital and companies, by widening the focus of investing to include not only profits but also the wider picture of corporate governance.

### *Sustainability*

One of the recommendations aimed at strengthening regulation and enforcement is that directors with fiduciary duties should not only act with an economic lens but should also bear in mind issues of sustainability and the environment in which they operate. Capital providers such as institutional investors can demand this because as a society we need to be aware of unpriced externalities on our planet. For example, the energy and chemical company, SASOL, is the biggest single emitter of carbon dioxide in the world.<sup>99</sup> How does one put a price on such an externality? The British Liberal Democratic politician and Business Secretary, Vince Cable eloquently posed the question ‘are the markets working in the long term benefits of the people?’<sup>100</sup> Institutional investors, and all investors in general, need to be engaged on the issue of responsible investing. Thus, business plans must take into consideration the long-term effect of business conduct as opposed to thinking of gain in the short-term. Short-term gains could include, say, a doubling of profits, but

<sup>98</sup> ‘About the UNPRI Initiative,’ <http://www.unpri.org/about-pri/about-pri/> < Accessed 16 February 2016.

<sup>99</sup> Ashton Glenn, ‘Johannesburg’s appalling air quality: We can’t let SASOL and ESKOM off the Hook,’ The South African Civil Society Information Service, 19 August 2014 <http://sacsis.org.za/site/article/2106>

<sup>100</sup> British Business Secretary Vince Cable posed this question to Professor Kay during the presentation of the ‘Kay Review’ of the UK on equity markets and long-termism, 2012

without realising the impact this has on the earth, especially in African countries. It is believed that the next major population increase will be in emerging markets: the world currently has a population of over 7 billion<sup>101</sup> people, in comparison with the end of 2<sup>nd</sup> World War in 1945, when the global population was 2.6 billion people. These figures speak for themselves and cannot be ignored; they underline the need for sustainable practices to be strongly emphasised in corporate governance, by changing the way business strategies are implemented.

## 5.2. CONCLUSION

The way forward can be summarised in five basic points. Firstly, Zambia must improve its systems of corporate governance, accountability and transparency to ensure effective enforcement and regulatory results. Incorporating the reviews and recommendations made throughout this dissertation and taking note of the setbacks and limitations that weaken proper regulation and enforcement of corporate governance would be a sound starting point.

Secondly, the Zambian corporate governance Code (the LuSE Code) should strengthen its position by attending to the points raised in section III of this thesis: Law and Practice of Corporate Governance in Zambia. Thus, the Code needs to be stricter and also needs to find a way to provide special provisions for the inclusion of small- and medium-sized local and foreign businesses (e.g. Chinese businesses) to participate and be held accountable over their corporate governance principles.

Thirdly, Zambia and other African countries need generally to strengthen their legal and corporate governance environment by fighting corruption and upholding the rule of law while giving regulatory institutions and agencies the independence to perform. Without this, the aim of good business practices and corporate governance will not be achieved on the African continent: this represents a challenge. In Zambia, in particular, this issue urgently highlights the need for the revision and expansion of corporate governance provisions in the Zambian Companies Act. It also highlights the

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<sup>101</sup> The United States of America Census Bureau: U.S. and World Population Clock  
<http://www.census.gov/popclock/>



need to continue using the IoDZ as an advocate and promoter of corporate governance principles in the country.

Furthermore, the institutions and organs responsible for ensuring compliance of corporate governance principles need to promote the style of integrated reporting as an indirect check system to ensure corporations are abiding by the requirements by reporting on their activities in a concatenated manner.

Last but not least, a call for responsible investing is a key factor to ensure enforcement of corporate governance. This will ensure that the financial investments in companies are interlinked with the sustainability of the activities undertaken by the companies. Responsible investment by way of taking into consideration the short, medium term and long-term impact and effects of investments would positively contribute to ensuring effective regulation and enforcement of corporate governance.

In conclusion: this paper has set out the challenges of enforcing corporate governance principles in Zambia and at the same time offered solutions by laying out recommendations and how best to overcome these challenges as a prescription to the problems of enforcement.

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